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Supreme Court, U.S.
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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1992

JAMES E. CROZIER, CHAPTER 11 TRUSTEE

Petitioner

v.

THERON BRADFORD, TRUSTEE

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE FIFTH CIRCUIT COURT OF APPEALS

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

WHETHER THE COURT OF APPEALS ERRED IN DETERMINING THAT 11 U.S.C. § 506(b) REQUIRES THAT AN OVERSECURED CREDITOR RECEIVE INTEREST AT THE CONTRACT RATE?

LIST OF PARTIES

The following persons are parties to this Petition for Writ of Certiorari:

James Crozier, Chapter 11 Trustee for the Bankruptcy Estate for Wayne Laymon

Theron Bradford, Managing General Partner of Bradford, Mayberry Properties, Inc. Group No. B-16

The following persons are limited partners of Bradford, Mayberry Properties, Inc. Group No. B-16:

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Otto Brandt
G. R. Ferguson
Diane Finch
John L. Fostor
Calvin Jayroe
Lewis Jennings
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PETITION FOR WRIT OF CERTIORARI

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

James E. Crozier, Petitioner, herein, prays that a Writ of Certiorari issue to review the

Judgment of the Fifth Circuit Court of Appeals entered in the above-entitled case on April 8, 1992.

OPINIONS BELOW

The Judgment of the Fifth Circuit Court of Appeals, which is herein sought to be reviewed, is reprinted in the Appendix to this Petition, page A-1. The Opinion of the Fifth Circuit Court of Appeals On Suggestion for Rehearing En Banc, which is noted at 964 F.2d 1145 (5th Cir. 1992), is reprinted in the Appendix to this Petition, page A-3. The Opinion of the Court of Appeals, which is published at 958 F.2d 72 (5th Cir. 1992) is reprinted in the Appendix at page A-5. The Order of the United States District Court is reprinted in the Appendix, page A-18. The Order on Motion to Reconsider and Trustee's Cross-Motion to Reconsider Order on Motion for Award of Interest, Costs and Fees Under § 506(b) is reprinted in the Appendix, page A-25. The Decision on Motion to Reconsider which is

published at 117 B.R. 856, is reprinted in the Appendix, page A-30.

JURISDICTION

The Judgment of the Fifth Circuit Court of Appeals was entered April 8, 1992. A timely Suggestion for Rehearing En Banc (which is also considered to be a petition for panel rehearing under the rules of the Fifth Circuit Court of Appeals) was filed on May 2, 1992. Panel rehearing was denied on May 21, 1992. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 502(b)(2):

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim

in lawful currency of the United States as of the date of filing of the petition, and shall allow such claim in such amount except to the extent that --

(2) such claim is for unmatured interest.

11 U.S.C. § 506(b):

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 726(a)(5):

(a) Except as provided in § 510 of this title, property of the estate shall be distributed --

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition,

on any claim paid under paragraph (1), (2), (3), or (4) of this subsection.

11 U.S.C. § 1129(b)(2)(A)(i)(II):

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) with respect to a class of secured claims, the plan provides --

(i)(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holders' interest in the estate's interest in such property.

12 U.S.C. § 1225(a)(5)(B)(ii):

(5) with respect to each allowed secured claim provided for by the plan --

(B)(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim...

11 U.S.C. § 1325(a)(5)(B)(ii):

(5) with respect to each allowed secured claim provided for by the plan --

(B)(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim...

28 U.S.C. § 1961(a):

(a) Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefor may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied for interest on judgments recovered in the courts of the State. Such interest shall be

calculated from the date of the entry of the judgment, at a rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of fifty-two week United States Treasury bills settled immediately prior to the date of the judgment. The Director of the Administrative Office of the United State Courts shall distribute notice of that rate and any changes in it to all Federal judges.

STATEMENT OF CASE

A. Factual Background.

On August 18, 1983, Wayne Laymon ("Laymon"), the Debtor, executed a Promissory Note payable to Theron Bradford, Trustee ("Bradford"), in the original principal amount of $669,900.00. The Note was secured by a lien upon approximately 79.72 acres of real property located in Travis County, Texas. The Note provided for annual

payments in the amount of $66,990.00 for four years to cover accrued interest with a balloon payment due on August 24, 1988. The Note provided for interest at the rate of 10% per annum prior to default and default interest at the highest legal rate.

The Debtor failed to make the payment due on August 18, 1984. The Debtor subsequently filed a voluntary Petition under Chapter 11 on September 4, 1984.

In 1986, the Debtor made adequate protection payments to Bradford totalling $311,165.00. Subsequently, James E. Crozier ("Crozier") was appointed as Chapter 11 Trustee. The Trustee made additional adequate protection payments totalling $315,000.00.

B. Proceedings Below.

On May 8, 1989, Bradford filed a Motion Requesting Payment of Interest, Costs and Fees

under § 506(b) of the Bankruptcy Code. After a hearing on stipulated facts, the Bankruptcy Court denied Bradford's request for penalty interest, but allowed post-petition interest on the claim at the pre-default contract rate of 10%. It was stipulated at the hearing that Bradford held an oversecured claim.

Bradford filed a Motion for Reconsideration, and the Trustee filed a Cross-Motion for Reconsideration. After another hearing, the Court vacated its prior order and held that the Federal judgment interest rate of 28 U.S.C. § 1961(a) provided the proper measure of interest to an oversecured creditor. *In re Laymon*, 117 B.R. 856 (Bankr.W.D.Tex. 1990). The Bankruptcy Court relied upon this Court's holding in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), which interpreted § 506(b). In *Ron Pair*, the Supreme Court held that

the phrase "interest on such claim" in § 506(b) was independent of the statutory language referring to fees, costs or charges provided for under the agreement. The Bankruptcy Court determined that interest under § 506(b) was not governed by the contract. 117 B.R. at 858, A-39. Therefore, the Court looked to Federal law to fashion an appropriate rate. After extensive analysis, the Court applied the Federal judgment rate, likening the award of post-petition interest to a Federal judgment. 117 B.R. at 859-65, A-43 to 69.

On appeal, the District Court affirmed, stating:

> The Supreme Court has construed the clear language of § 506(b) to indicate that an award of interest is separate and independent from "the agreement under which such claim arose." (citation omitted). The language of *Ron*

> *Pair* persuades the Court that the award of interest in a case such as the present one does not depend upon the provisions of the Note or Contract at issue.

A-23 to 24.

On April 8, 1992, the Fifth Circuit rendered an Opinion reversing the District Court. The Fifth Circuit relied upon this Court's holding in *Dewsnup v. Timm*, ___ U.S.___, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). The Fifth Circuit determined that the legislative history to § 506(b) did not evidence an intent to change practice under the Bankruptcy Act. 958 F.2d at 74-75; A-13 to 14. The Fifth Circuit also ruled that under the Bankruptcy Act, the practice was to apply the contract rate. 958 F.2d at 75; A-14 to 15. Therefore, the Fifth Circuit reversed and held that the contract rate should have been applied. The Fifth Circuit remanded the case to the

lower Courts to determine whether the pre-default or post-default contract rate should be applied. 958 F.2d at 75; A-15 to 17.

On May 2, 1992, Crozier filed a Suggestion for Rehearing En Banc. Although a poll was requested by a member of the Fifth Circuit, a majority of the Judges did not vote to grant Rehearing En Banc. The panel considered the Suggestion for Rehearing En Banc as a request for panel rehearing and denied the request. A-3.

FEDERAL QUESTION RAISED

Pursuant to 28 U.S.C. § 157(b)(2) and § 1334, the Courts of the United States have jurisdiction over matters concerning claims in bankruptcy. When Theron Bradford, Trustee filed his Motion for Interest, Costs and Fees under § 506(b) on May 8, 1989, a Federal question was raised.

REASONS FOR GRANTING WRIT

Issue: Whether the Court of Appeals erred in determining that 11 U.S.C. § 506(b) requires that an oversecured creditor receive interest at the contract rate?

This case concerns the proper rate of interest to be paid to an oversecured creditor pursuant to 11 U.S.C. § 506(b). The Bankruptcy Court and the District Court held that 11 U.S.C. § 506(b) does not require payment of the contract rate to an oversecured creditor and applied the Federal judgment rate. The Fifth Circuit Court of Appeals reversed, holding that the contract rate should be applied based upon practice under the Bankruptcy Act.

Review is sought pursuant to Supreme Court Rule 10.1(c) which provides as follows:

.1. A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

> (c) When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way that

conflicts with applicable decisions of this Court.

Review by Certiorari is requested to interpret 11 U.S.C. § 506(b) in light of this Court's prior rulings in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) and *Dewsnup v. Timm*, ___ U.S.____, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). In *Ron Pair*, this Court ruled that the statutory language of 11 U.S.C. § 506(b) allowed interest to an oversecured statutory lien creditor, even though this changed practice under the Bankruptcy Act. In *Laymon*, the Fifth Circuit (relying on *Dewsnup*) held that an oversecured creditor with a contract was entitled to interest at the contract rate based upon prior practice under the Bankruptcy Act, even though the language of § 506(b) does not require interest at the contract rate.

Although this issue has not resulted in a split

of authority among the Courts of Appeals, it has produced a division among the lower Courts. Compare *Matter of Laymon*, 958 F.2d (5th Cir. 1992), *reh.den.* 964 F.2d 1145 (contract rate applied based upon Act practice); *In re Anderson*, 833 F.2d 834 (9th Cir. 1987) (contract rate applied without analysis); *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989)(no authority to modify contract rate); *Matter of Lauretti Corp.*, 86 B.R. 751 (Bankr.D.Conn. 1986)(contract rate applied but creditor could not enforce provision to increase contract rate post-petition); *In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986)(§ 506(b) refers to rate provided in agreement); *In re Loveridge Machine and Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983)(court did not rely upon grammar of § 506(b) but applied contract rate based upon equitable principles) with *In re Laymon*, 117 B.R. 856 (Bankr.W.D.Tex. 1990), *rev'd.*, 958 F.2d 72 (5th Cir.

1992)(Federal judgment rate applies under § 506(b)); *In re Kelton*, 137 B.R. 19 (Bankr.W.D.Tex. 1992)(tax lien creditor entitled to federal judgment rate); *In re Laza*, 69 B.R. 669 (Bankr.E.D.N.Y. 1987)(market rate applies); *In re Anderson*, 28 B.R. 628 (S.D.Oh. 1982)(legal rate); *In re Brooks*, 24 B.R. 447 (Bankr.D.Kan. 1982)(market rate); *In re Marx*, 11 B.R. 819 (Bankr.S.D.Oh. 1981)(legal rate).

Decisions applying the contract rate fall into three major categories. A significant group of cases either assume that § 506(b) requires interest at the contract rate based upon the use of the term "agreement" in § 506(b), *In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986), or find that the contract rate should apply because § 506(b) does not expressly authorize modification of the contract rate, *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989). The decision of the Court of Appeals in the present case required application of the contract

rate based upon practice under the Bankruptcy Act, *Matter of Laymon*, 958 F.2d 72 (5th Cir. 1992). Finally, a third line holds that the contract rate should apply based upon practical and equitable considerations, *In re Loveridge Machine and Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983).

In this Petition for Writ of Certiorari, Petitioner will show that neither the statutory language of the Bankruptcy Code nor the historical practice under the Bankruptcy Act require application of the contract rate. Interest under § 506(b) is a matter of Federal law and does not require deference to state interest rates. The Federal judgment rate furnishes a measure of interest which is logical, practical and equitable, so that the Fifth Circuit erred in reversing the judgment of the District Court.

A. The Statutory Language Does Not Require the Contract Rate.

The task of interpreting a statute begins with the language of the statute itself. "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.'" *United States v. Ron Pair Enterprises, Inc.*, 109 S.Ct. at 1031.

In this case, two statutory sections are directly relevant to the interest paid to an oversecured creditor. 11 U.S.C. § 502(b)(2) provides that claims shall be allowed "except to the intent that such claim is for unmatured interest." § 502(b)(2) operates to displace contractual and statutory entitlements to interest outside of bankruptcy. Any right to post-petition interest must be provided for by the Bankruptcy Code itself, as opposed to the State law contract. However, § 502(b)(2) only disallows claims for "unmatured"

interest. Therefore, claims for interest accruing prior to bankruptcy are recognized based upon the contract or other applicable source.

There are two provisions of the Bankruptcy Code which allow interest during the period post-petition but prior to confirmation of a plan. 11 U.S.C. § 506(b) allows interest to an oversecured creditor, while 11 U.S.C. § 726(a)(5) allows interest at the legal rate to a creditor of a solvent Chapter 7 Estate.

The award of interest in this case is based upon § 506(b) which provides:

> (b) to the extent that an allowed secured claim secured by property the value of which, after any recovery under sub-section (c) of this Section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim,

> and any reasonable fees, costs, or charges provided for under the Agreement under such claim arose. (emphasis added).

While § 506(b) provides for interest to oversecured creditors, it does not state which rate is to be applied:

> However, it is the opinion of this Court that § 506(b) requires only that the oversecured creditor receive some rate of interest. It does not require that it receive the contract rate of interest, although it does require that the contract determine the allowable expenses and costs (emphasis in original).

In re Brooks, 24 B.R. 447, 449 (Bankr.D.Kan. 1982).

Some Courts have disagreed with this

analysis, holding that the phrase "interest on such claim" was part of the same phrase containing "any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." Based upon this construction of the statute, these Courts concluded that § 506(b) required interest at the contract rate. *E.g., In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn. 1986); *Matter of Johnston*, 44 B.R. 667 (Bankr.W.D.Miss. 1984).

These cases are inconsistent with the Court's ruling in *Ron Pair Enterprises, Inc.*, in which this Court held that the phrase "interest on such claim" was independent of the statutory language referring to fees, costs or charges provided for under the agreement.

> This reading is also mandated by the grammatical structure of the statute. The phrase "interest on such claim" is set aside by commas, and separated

> from the reference to fees, costs and charges by the conjunctive words "and any." As a result, the phrase "interest on such claim" stands independent to the language that follows. "Interest on such claim" is not part of the list made up of "fees, costs or charges," nor is it joined to the following cause so that the final "provided for under the agreement," modifies it as well (citation omitted). The language and punctuation Congress used cannot be read in any other way. By the plain language of the statute, the two types of recovery are distinct.

United States v. Ron Pair Enterprises, Inc., 109 S. Ct. at 1030-31.

The Bankruptcy Court correctly relied upon *Ron Pair* to reject the cases which found that §

506(b) mandated interest at the contract rate.

Giving full effect to the Supreme Court's interpretation of that comma leads ineluctably to the conclusion that the entire issue of interest is completely divorced from either the existence or the content of any underlying agreement.

Case law prior to *Ron Pair* is of little assistance in resolving the issue, as most Courts confronting the rate question for consensual lienholders had settled on the contract rate by relying (explicitly or implicitly) on the statute's reference to "that amount provided for under the agreement under which such claim arose." (citations omitted). After *Ron Pair*, that logic is considerably less persuasive.

> Once the comma is given effect, leaping past it to the statute's reference to "the agreement" is no longer permissible.

In re Laymon, 117 B.R. at 858-59, A-40-41.

A related line of cases holds that because Congress did not specifically provide for modification of contractual interest rates in § 506(b), that Congress intended for such contracts to control. *In re Gladdin*, 107 B.R. 803 (Bankr.M.D.Ga. 1989); *In re Melbell Associates, Inc.*, 99 B.R. 31 (Bankr.E.D.Cal. 1989); *In re Skyler Ridge*, 80 B.R. 500 (Bankr.C.D.Cal. 1987) ("no authorization in § 506(b) to examine the reasonableness of the interest rate charged by the secured creditor").

The difficulty with these cases is that they presume that the Bankruptcy Code generally defers to contractual interest rates. In fact, the opposite is true. The Bankruptcy Code thoroughly regulates

and modifies recovery of interest in bankruptcy. § 502(b)(2) generally pre-empt rights to interest payable under state law. § 726(a)(5) allows interest to creditors of solvent bankruptcy Estates at the "legal rate." § § 1129(b), 1225(a)(5) and 1325(a)(5) all provide for interest under plans of reorganization to be paid at a market rate rather than a contract rate.

Interest at the contract rate is the exception rather than the rule and is limited to several narrow circumstances. First of all, under § 502(b)(2), matured, pre-petition interest is calculated at the contract rate. This is so because the statute pre-empts only "unmatured" interest.

Second, 11 U.S.C. § 1124(1) states that a claim is impaired unless the Chapter 11 plan "leaves unaltered the legal, equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest."

Unimpaired classes of claims are not entitled to vote on a Chapter 11 plan and thus constitute a narrow subset of claims which may be treated under a Plan.

Finally, 11 U.S.C. § 1322(b)(2) provides that a Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the Debtor's principle residence, ..." Once again, § 1322(b)(2) is a narrow exception to the treatment of claims in a Chapter 13 plan.

Thus, where Congress wished to leave State law interest entitlements intact, it was able to draft specific language to address specific situations. It is not reasonable to presume that Congress intended the contract rate when it used the term "interest." The Courts relying upon this interpretation essentially read the statute to provide for "interest under applicable non-bankruptcy law

on such claim."

However, this Court has recently warned against reading statutory terms more narrowly than they are written. In *Patterson v. Shumate*, ___ U.S. ____, 112 S.Ct. 2242 (1992), this Court reversed a holding that the term "applicable non-bankruptcy law" referred only to State spendthrift trust law and not to restrictions under ERISA. Similarly, in this case, it is not appropriate to read the term "interest" to mean "interest under applicable non-bankruptcy law."

The statutory text provides no basis for concluding that Congress mandated the contract rate. Therefore, it is necessary to turn to the historical analysis utilized by the Fifth Circuit.

B. Historical Analysis Does Not Require Application of the Contract Rate.

In reversing the lower Courts, the Fifth Circuit did not adopt the prevalent analysis that the

statutory language of § 506(b) requires application of the contract rate. Rather, the Fifth Circuit held that practice under the Bankruptcy Act required this result.

> Even though we hold *Ron Pair* does not affect the rate of interest applied in § 506(b), we still must determine what rate of interest applies in this case. The Supreme Court "has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, __ U.S.___, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992). The legislative history of §

> 506(b) does not refer to a rate of interest. (citation omitted). The language of § 506(b) does not refer to a rate of interest. See 11 U.S.C. § 506(b). Therefore, we must conclude that Congress did not intend for § 506(b) of the Code to effect a major change in pre-Code practice concerning the rate of interest applied under the Section. (citation omitted).

Matter of Laymon, 958 F.2d at 74; A-12 to 13.

The Fifth Circuit went on to state that "Prior to the enactment of the Code, the majority of Courts utilized the contract rate of interest when allowing an oversecured creditor to collect post-petition interest pursuant to § 506(b)." 958 F.2d at 75; A-14. The Fifth Circuit based this statement on a treatise which it cited. Based upon this interpretation of pre-Code practice, the Fifth Circuit

required that post-petition interest be calculated at the contract rate.

Intent to codify practice under the Bankruptcy Act does not furnish a basis for applying the contract rate in this case. The Fifth Circuit relied upon a presumption that Congress would not change practice under the Act without making a statement in the legislative history. However, in *Ron Pair*, this Court warned against reading too much into omissions from legislative history, stating:

> Initially, it is worth recalling that Congress worked on the formulation of the Code for nearly a decade. It was intended to modernize the Bankruptcy laws (citation omitted), and as a result made significant changes in both substantive and procedural laws of Bankruptcy. (citation omitted). In

> particular, Congress intended "significant changes from current law in... the treatment of secured creditors and secured claims." In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took.

United States v. Ron Pair Enterprises, Inc., 109 S.Ct. at 1030.

There are three principal reasons not to rely upon the Fifth Circuit's historical analysis in this case. First, it is clear that in adopting § 506(b), Congress made several changes to practice under the Bankruptcy Act which are not discusssed in the legislative history. The existence of such changes rebuts the presumption that Congress would have documented any changes it intended to make. Second, Act decisions concerning interest rates to

oversecured creditors were not uniform and are not helpful in light of the distinctions between the Code and the Act. Finally, a per se rule applying the contract rate is inconsistent with the overall structure of the Bankruptcy Code.

The legislative history to § 506(b) is not extensive. The House Report states:

> Subsection (b) codifies current law by entitling a creditor with an oversecured claim to any reasonable fees, costs or charges provided under the agreement under which the claim arose. These fees, costs and charges are secured claims to the extent that the value of the collateral exceeds the amount of the underlying claim.

H.R.Rep.No. 595, 95th Cong., 1st Sess., 356-57 (1977), 1978 U.S.Code Cong.&Admin.News 5787, 6312. The legislative history does not discuss

interest on oversecured claims. The fact that fees, costs and charges provided for under the agreement are discussed separately appears to confirm the holding in *Ron Pair* that interest is a separate form of recovery from fees, costs and charges.

§ 506(b) modified, clarified and altered practice under the Bankruptcy Act in several respects which are not discussed above. Under the Act, there was a split of authority as to whether oversecured creditors were entitled to interest as a matter of right. One line of cases recognized three circumstances in which post-petition interest would be allowed, including when the security for a claim was worth more than the amount of the claim. *United States v. Bass*, 271 F.2d 129 (9th Cir. 1959). However, a second line of cases allowed interest to oversecured creditors only where it was equitable to do so, there was a solvent estate or the interest was paid out of income generated from the property.

Smith v. Robinson, 343 F.2d 793 (4th Cir. 1965); *United States v. Harrington*, 269 F.2d 719 (4th Cir. 1959); *Beecher v. Leavenworth State Bank*, 192 F.2d 10 (9th Cir. 1951); *In re Leed's Homes, Inc.*, 222 F.Supp.20, 33-34 (E.D.Tenn. 1963). Indeed, the *Beecher* case went so far as to state that the exception allowing interest to oversecured creditors had been repudiated by the Supreme Court in *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946). The Fifth Circuit has stated that an oversecured creditor's right to interest under the Bankruptcy Act depended "on the equities on the situation." *In re Timbers of Inwood Forest, Ltd.*, 793 F.2d 1380, 1386 (5th Cir. 1986).

Under the Act, it was not clear that oversecured creditors were entitled to post-petition interest. When the Bankruptcy Code was adopted, § 506(b) clearly provided for post-petition interest to

oversecured creditors. However, this change is not mentioned in the legislative history.

Another line of cases allowed post-petition interest to oversecured creditors holding consensual liens but denied post-petition interest to holders of statutory liens. *United States v. Harrington*, 269 F.2d at 722-23; *United States v. Bass*, 271 F.2d 129 (9th Cir. 1959); *In re Kerber Packing Company*, 276 F.2d 245 (7th Cir. 1960); *In re Boston and Maine Corp.*, 719 F.2d 493 (1st Cir. 1983), *cert. den. sub nom. City of Cambridge v. Meserve*, 466 U.S. 938 (1984); *State Board of Equalization v. Stodd*, 500 F.2d 1208 (9th Cir. 1974). In *Ron Pair*, this Court held that the statutory language of § 506(b) allowed interest to oversecured statutory lien creditors, even though the legislative history did not address this change.

Additionally, under the Act, it was frequently held that recovery of attorney's fees by secured

creditors was governed by State law and that the provisions of the Bankruptcy Act with respect to attorney's fees did not apply. *Security Mortgage Company v. Powers*, 278 U.S. 149, 49 S.Ct. 84, 73 L.Ed. 236 (1928); *In re Continental Vending Machine Corp.*, 543 F.2d 986 (2nd Cir. 1976); *In re Crafty Fox Limited*, 475 F.Supp. 634 (W.D.Va. 1979); *In re Holiday Mart, Inc.*, 9 B.R. 99 (Bankr.D.Hawaii 1981). But see, *First Savings Bank and Trust Company v. Stuppi*, 2 F.2d 822 (8th Cir. 1924)(Bankruptcy Court could fix reasonable fees.) Under the Bankruptcy Code, it is now recognized that recovery of attorney's fees by a secured creditor is a matter of Federal law and that creditors must prove reasonableness even if this is not required by State law. *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051 (5th Cir. 1986). The change with respect to attorney's fees is particularly significant due to the fact that the legislative history which does exist for

§ 506(b) specifically states an intent to codify prior law. However, despite this legislative history, the Courts have followed the language of the statute to effect a change in pre-Code practice.

It is clear that § 506(b) changed more than was addressed in its legislative history. Therefore, it would be a mistake to place too much emphasis on any particular omission from the legislative history. This is particularly so because the practice of awarding interest at the contract rate to oversecured creditors provides a poor model to follow in the first place.

In *Matter of Laymon*, the Fifth Circuit cited a treatise for the proposition that prior to enactment of the Code, the majority of Courts utilized the contract rate of interest on oversecured claims. 3 Collier on Bankruptcy, para. 506.05, at 506-46. Collier on Bankruptcy, in turn, cited to five cases under the Act and one case under the Code.

Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed.162 (1946); *Sexton v. Dreyfus*, 219 U.S. 339, 31 S.Ct. 256, 55 L.Ed. 244 (1911); *In re Black Ranches, Inc.*, 362 F.2d 8 (8th Cir.), *cert. den.*, 385 U.S. 990 (1966); *In re Magnus Harmonica Corp.*, 262 F.2d 515 (3rd Cir. 1958); *Weeks v. McInnis*, 200 F.2d 611 (6th Cir. 1952), *cert. den.*, 345 U.S. 958 (1953); and *In re United Merchants and Manufacturers, Inc.*, 674 F.2d 134 (2nd Cir. 1982). However, none of these cases dealt with the rate of interest to an oversecured creditor. Each of the Act cases cited dealt with allowability of certain types of interest rather than the rates to be paid. The Code case cited dealt with recovery of attorney's fees.

Most cases under the Act did not directly address the proper rate of interest to be paid to a secured creditor. As stated above, some Courts denied post-petition interest to secured creditors

entirely unless it was consistent with equitable principles. *Smith v. Robinson*; *Beecher v. Leavenworth State Bank*. Several cases specifically required payment of the contract rate. *United States v. Sampsell*, 153 F.2d 731 (9th Cir. 1946); *In re International Raw Material Corporation*, 22 F.2d 920 (2nd Cir. 1927); *San Antonio Loan & Trust Co. v. Booth*, 2 F.2d 590 (5th Cir. 1924); *Matter of Schrader Body, Inc.*, 315 F.Supp. 1349 (W.D.Penn. 1970); *In re Stevens*, 173 F. 842 (D.Ore. 1909). On the other hand, some Courts limited interest rates. *Levin v. Johnson*, 7 F.2d 885 (7th Cir. 1925)(reducing interest from 40% to 7% despite absence of corporate usury statute); *Richter v. Goetz*, 253 F. 938 (7th Cir. 1918)(limiting interest on purchased tax claims to 6%).

The courts which explicitly required application of the contract rate did so for reasons which are inconsistent with the present Bankruptcy

Code. Under the Bankruptcy Act of 1898, § 67d (11 U.S.C. § 107 (repealed)) prevented a Court from modifying a lien. This was the basis for the rulings in *Sampsell*, *International Raw Material*, *San Antonio Loan & Trust Co.* and *Stevens*. However, this is specifically not the case under the Bankruptcy Code. The Bankruptcy Code allows liens to be modified in numerous circumstances. See § § 506(b) (denying interest to undersecured lien creditors); 522(f), 544, 545, 547, 548, and 549 (avoiding liens); 722 (allowing redemption for value); 724 (subordinating tax liens); 1129(b), 1225(a)(5) and 1325(a)(5) (allowing modification of interest rate on secured claims). In each of these circumstances, liens may be avoided, striped down or have their interest rates modified.

In the *Schrader Body* case, the Court cited an unwillingness to change the terms of the valid and subsisting contracts. However, the Bankruptcy

Code modifies contracts in many respects, including post-petition interest.

As discussed more fully above, the legislative history and practice under the Act should be weighed against the structure of the Bankruptcy Code. The Bankruptcy Code thoroughly regulates interest accruing post-petition. The instances in which the Code permits a contract rate to apply post-petition are specific and limited.

Thus, the Fifth Circuit erred when it relied upon the legislative history and the practice under the Bankruptcy Act to determine that the contract rate was required.

C. Selecting a Federal Interest Rate.

§ 506(b) does not specify an interest rate to be applied to oversecured claims. The legislative history is silent as well. Therefore, Bankruptcy Courts are given discretion to select an appropriate interest rate consistent with common law and the

principles of the Bankruptcy Code. The Bankruptcy Court in this case reviewed the precedents of the Supreme Court and other Courts with respect to interest in Bankruptcy and reviewed the structure of the Bankruptcy Code to determine that the Federal judgment rate was an appropriate rate to apply in the present case. This determination was correct and should have been affirmed.

The federal courts have extensive experience in awarding interest in bankruptcy. The Sixth Circuit summarized this experience, stating:

> The reorganization court must consider whether to grant post-petition interest, not as an abstract matter, but in light of the nature of each claim and the equities of the case before it. At all times, the reorganization court must be guided by the basic principle announced in *Vanston Bondholders*

Protective Committee v. Green (citation omitted):

> It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balancing of the equities between creditor and creditor or between creditors and the debtor.

In re Kentucky Lumber Company, 860 F.2d 674, 677 (6th Cir. 1988).

Several principles apply to recovery of post-petition interest. Awards of post-petition interest are a matter within the discretion of the Federal court and arise under Federal law. In *Vanston Bondholders Protective Committee v. Green*, the Supreme Court stated that, "When and under what circumstances Federal courts will allow interest on claims against Debtors' estates being administered

by them has long been decided by Federal law." 67 S.Ct. at 240.

The First Circuit has stated that interest in bankruptcy is awarded based upon the intervention of Federal law.

> (1) Interest is a penalty or damages assessed for detention of money by the Debtor, so it is not appropriate to assess that penalty against other creditors who are not to blame for the detention.
>
> (2) It is the Court, not the debtor, that is doing the "detaining" post-petition.

Debenture Holders Protective Committee v. Continental Investment Corp., 679 F.2d 264, 269 (1st Cir. 1982), *cert. den'd.* 459 U.S. 894.

Relying upon these precedents, the Bankruptcy Court stated:

> The justification for interest, if it is to be paid at all, is in compensation for the detention of money occasioned by the Bankruptcy case itself, a detention visited equally on all creditors of the bankruptcy estate by a process operating under the exclusive auspices of the Federal judicial system, and a detention not directly related to the pre-petition agreements the debtor struck with its creditors. The obligation is the bankruptcy estate's, not the debtor's.

In re Laymon, 117 B.R. at 860; A-48.

Although the contract rate has little significance under federal law, the judgment rate does. A judgment in an adversary proceeding in bankruptcy bears interest at the Federal judgment rate. *In re Southern Indus. Banking Corp.*, 87 B.R.

518 (Bankr. E.D. Tenn. 1988); *In re Goldblatt Brothers.*, 61 B.R. 459 (Bankr. N.D. Ill. 1986). An allowed claim in bankruptcy is similar to "a Federal judgment against estate assets enforcible only in Federal court." *In re Laymon*, 117 B.R. at 862; A-57.

The Federal judgment rate also applies under 11 U.S.C. § 726(a)(5). § 726(a)(5) provides that creditors of a solvent Chapter 7 Estate are entitled to receive interest at the "legal rate." The legal rate is the Federal judgment rate under 28 U.S.C. § 1961(a). *In re Godsey*, 134 B.R. 865 (Bankr. M.D. Tenn. 1991). § 726(a)(5) is the other section of the Bankruptcy Code which authorizes recovery of interest post-petition but prior to confirmation of a plan of reorganization. Therefore, it is logical to look to § 726(a)(5) to interpret § 506(b).

The underlying purpose of any bankruptcy system is the ratable, equitable distribution of

assets among creditors of the estate.

The Bankruptcy Court in this case stated:

> The general purpose of a bankruptcy statute is the equitable distribution of the debtor's assets among the debtor's creditors. (citation omitted). A number of significant consequences flow from this simple statement of the obvious. First, bankruptcy statutes should be interpreted to give effect to this underlying principle. Second, all similarly situated creditors should be similarly treated. Third, creditors should not be preferred absent special legal or equitable considerations warranting preferential treatment.

In re Laymon, 117 B.R. at 861; A-50-51.

In applying these principles to § 506(b), the Bankruptcy Court properly concluded that the

Federal judgment rate was an appropriate rate to apply. The Bankruptcy Court stated that, "The interest contemplated under § 506(b) is most sensibly construed as an equitable award arising under Federal law to compensate the oversecured creditor for the delay caused by the Bankruptcy case itself." 117 B.R. at 863; A-61. The Court went on to state that:

> The principle of equitable, ratable distribution of assets among creditors also lends support to the use of the Federal rate in computing § 506(b) interest awards. Any equity over and above the creditor's allowed secured claim belongs to the general pool of assets available to unsecured creditors. The competition for this asset is not between creditors and the debtor but between two different groups of

creditors, secured and unsecured. The use of the Federal judgment rate gives effect to Congress' intent that secured creditors have a "first claim" on that excess collateral value to compensate it for the bankruptcy delay. At the same time, it prevents overreaching by the oversecured creditor. (citations omitted). . . . Because the rationale for paying post-petition interest is to compensate for the delay imposed by the bankruptcy process (which delay is visited equally on all creditors), there is little justification for making unsecured creditors pay the secured creditor a rate of interest derived from a pre-petition agreement to which they were not a party. Use of the Federal rate yields an equitable solution to the

> competing claims of the secured and unsecured creditor that also honors the principle of applying Federal law to the payment of post-petition interest (citation omitted).

In re Laymon, 117 B.R. at 863-64; A-61 to 64.

The Federal judgment rate also has practical and equitable grounds to recommend it. The Federal judgment rate is an uniform rate which is set by an impartial authority. The Federal judgment rate is based upon the yield on 52 week treasury bills. The rate is determined by the Secretary of the Treasury and is distributed by the Director of the Administration Office of the United States Courts. Because the Federal judgment rate is based upon the auction price of 52-week T Bills, it is responsive to market forces and relates directly to the return an investor could obtain upon his money on a risk free investment. The rate of return

for a risk-free investment is an appropriate comparison for a creditor holding an oversecured claim.

It is also important to note that the contest in the present case is between a Chapter 11 Trustee, who is charged with obtaining the best return for the unsecured creditors, and a secured creditor, who was not satisfied with a 10% return and sought to extract an eighteen (18) percent penalty interest rate against the Estate's assets. The Federal judgment rate represents a fair compromise between the competing interests of the unsecured creditors and the secured creditor in this case.

Petitioner has located one other case which discussed interest rates under § 506(b) as a matter of Federal common law. *In re Loveridge Machine & Tool Company, Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983). In that case, the Court found that the contract rate should apply in cases in which there

is a contract based upon the following analysis:

> An interest rate should not be chosen by juggling rules of grammar. Neither should the selection of an interest rate be influenced by favoritism of debtors over creditors, creditors over debtors, or of some creditors over others. Using the lawful contract rate where there is a contract avoids such errors and provides a rule which is easily applied and consistent with authority and reason.
>
> Using any interest rate other than the contract rate, where there is a contract, would produce irrational results. To measure the reasonable fees, costs, and charges to be added to an allowed oversecured claim based on a contract, the court would look to the

contract. But to measure the interest to be added to the same claim, the Court would look outside the contract. Why should bankruptcy law enforce the parties' bargain with respect to fees, costs, and charges but not enforce it with respect to interest?...(R)ejecting the contract rate where there is a contract might mean either a windfall to the creditor when the contract rate is less than the rate selected or a windfall to the debtor when the contract rate exceeds the rate selected. Given the volatility of interest rates, contract rate will often differ from the prevailing market rate at the time of the hearing. The parties in this case have shown no good reason for producing a windfall under § 506(b).

In re Loveridge Machine & Tool Company, Inc., at 162 -63.

The Court in *Loveridge* identified some important factors. However, those factors tend to support the Federal judgment rate rather than the contract rate. First, the *Loveridge* court stated that selection of an interest rate should avoid favoritism among creditors and the Debtor. Applying an interest rate negotiated by the Debtor and the secured creditor pre-petition allows the Debtor to favor preferred creditors as against the body of creditors at large. Therefore, avoiding favoritism is best served by applying an uniform, national rate of interest.

Second, the *Loveridge* Court suggested that it would be irrational to look to the contract to determine fees, costs and charges but not to determine interest. However, the contract only determines whether fees, costs and charges will be

allowed. It does not define the rate at which such fees, costs and charges will be paid. Fees, costs and charges must be approved as reasonable under Federal law. *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051 (5th Cir. 1986); *In re Wonder Corp. of America*, 72 B.R. 580 (Bankr.D.Conn. 1987).

Next, the Utah Bankruptcy Judge stated that applying the contract rate would avoid a windfall in cases where there was a difference between contract and market rates. In fact, the contrary is true. Awarding a secured creditor an above market rate based upon a pre-petition contract results in a windfall to the secured creditor. Under a plan of reorganization, the secured creditor is only entitled to recover a market interest rate. There is no reason why a secured creditor should retain this advantage during the period between filing of the petition and confirmation of the plan. Such an advantage will only encourage secured creditors to

delay proceedings in order to retain their above market rates.

The factors applied by the Court in *Loveridge* do not support a mechanical application of the contract rate. Avoiding favoritism, consistency in statutory analysis and preventing windfalls are best served by applying federal rather than state law.

CONCLUSION

Interest under 11 U.S.C. § 506(b) is a matter of Federal law. Neither the statutory language, the legislative history nor practice under the Bankruptcy Act require application of the contract rate. Bankruptcy Courts should be allowed to select an appropriate Federal interest rate on a case by case basis.

The Bankruptcy Court did not abuse its discretion in selecting the Federal judgment rate in the present case. The Federal judgment rate is an uniform, market based rate and represents a fair

compromise between the interests of the secured creditor and the unsecured creditors. The secured creditor has not demonstrated any equities which would make it unfair to apply the Federal judgment rate. Indeed, the secured creditor has received post-petition payments of over $600,000.00 during this case. These payments, which would otherwise have been available for unsecured creditors, are approximately equal to the original principal amount of the claim.

Because the Bankruptcy Court ruled properly in selecting the interest rate, Petitioner requests that this Court grant the Petition for Writ of Certiorari, and that upon granting the Writ that the Judgment of the Fifth Circuit be reversed and the Order of the District Court be reinstated.

Respectfully submitted,

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92-312

Supreme Court, U.S.
FILED
AUG 17 1992

NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1992

JAMES E. CROZIER, CHAPTER 11 TRUSTEE
Petitioner

v.

THERON BRADFORD, TRUSTEE
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE FIFTH CIRCUIT COURT OF APPEALS

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 91-8255

D.C. Docket No. A-90-CA-1025

IN THE MATTER OF: WAYNE M. LAYMON,

Debtor.

THERON BRADFORD,

Appellant,

versus

JAMES CROZIER,

Appellee.

Appeal from the United States
District Court for the
Western District of Texas

Before THORNBERRY, GARWOOD, and DAVIS, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record

on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the District Court in this cause is reversed, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that appellee pay to appellant the costs on appeal to be taxed by the Clerk of this Court.

April 8, 1992

ISSUED AS MANDATE: June 01, 1992

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 91-8255

IN THE MATTER OF:

WAYNE M. LAYMON,

Debtor.

THERON BRADFORD,

Appellant,

versus

JAMES CROZIER,

Appellee.

Appeal from the United States District Court
for the Western District of Texas

ON SUGGESTION FOR REHEARING EN BANC

(Opinion 4-08-92, 5 Cir., 1992, 958 F.2d 72)

(May 21, 1992)

Before THORNBERRY, GARWOOD and DAVIS, Circuit Judges.

PER CURIAM:

( ) Treating the suggestion for rehearing en banc as a petition for panel rehearing, it is ordered that the petition for panel rehearing is DENIED. No member of the panel nor Judge in regular active service of this Court having requested that the Court be polled on rehearing en banc (Federal Rules of Appellate Procedure and Local Rule 35), the suggestion for Rehearing En Banc is DENIED.

(XX) Treating the suggestion for rehearing en banc as a petition for panel rehearing, the petition for panel rehearing is DENIED. The judges in regular active service of this Court having been polled at the request of one of said judges and a majority of said judges not having voted in favor of it (Federal Rules of Appellate Procedure and Local Rule 35), the suggestion for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/Homer Thornberry
United States Circuit Judge

In the Matter of Wayne M. LAYMON, Debtor.

Theron BRADFORD, Trustee, Appellant.

v.

James CROZIER, Trustee, Appellee.

No. 91-8255.

United States Court of Appeals, Fifth Circuit.

April 8, 1992.

Appeal from the United States District Court for the Western District of Texas.

Before THORNBERRY, GARWOOD, and DAVIS, Circuit Judges.

THORNBERRY, Circuit Judge:

The appellant, an oversecured creditor, appeals from the district court's affirmance of the bankruptcy court's decision awarding post-petition interest on appellant's oversecured claim at the federal judgment interest rate rather than at the contractual default rate. Because we find that the

district court and bankruptcy court incorrectly interpreted the Supreme Court's opinion in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), and incorrectly applied the federal judgment interest rate as the applicable rate of interest under §506(b) of the Bankruptcy Code, we reverse and remand to the district court.

I. Background

In August 1983, Wayne Laymon, the debtor, executed a promissory note in the original principal amount of $669,900.00 to Theron Bradford, Trustee. The Note provided for annual payments in the amount of $66,990 for four years to cover accrued interest and to reduce the principal, and a balloon payment due on August 24, 1988. Under the provisions of the Note, all unmatured amounts accrued interest at the rate of 10%, while all matured unpaid amounts accrued interest at the

highest rate permitted by law (the default rate), which the parties have stipulated to be 18%.

The debtor failed to make the first payment due under the Note on August 18, 1984, and filed a voluntary petition under Chapter 11 on September 4, 1984. In 1986 he made adequate protection payments to Bradford totalling $311,165, and the Trustee (Crozier) thereafter made additional adequate protection payments totalling $315,000. The Note matured by its terms on August 24, 1988. On May 8, 1989, Bradford filed a motion requesting payment of interest, costs, and fees under section 506(b) of the Bankruptcy Code, claiming that he was entitled to interest at the 18% penalty rate. After a hearing on stipulated facts, the bankruptcy court denied Bradford's request for penalty interest, but allowed post-petition interest on the claim at the pre-default contract rate of 10%.

Bradford filed a motion for reconsideration, and

the Trustee filed a cross-motion for reconsideration. After another hearing, the court vacated its prior opinion and held that the federal judgment interest rate of 28 U.S.C. §1961 provided the proper rate of interest at which post-petition interest accrued. *In re Laymon*, 117 B.R. 856, 864 (Bankr.W.D.Tex.1990). Bradford appealed the bankruptcy court's holding to the federal district court. The district court affirmed the opinion of the bankruptcy court. Bradford now brings this appeal.

II. Analysis

A. *The Standard of Review*

The parties contest the standard of review to be applied by this court. Bradford submits that this appeal presents solely a question of law reviewable de novo. The Trustee, on the other hand, argues that awards and denials of post-petition interest are equitable determinations,

reviewed for abuse of discretion.

The district court simply affirmed the bankruptcy court's order based on the reasoning in the bankruptcy court's opinion. It is clear that the foundation of the bankruptcy court's decision is its interpretation of the Supreme Court's opinion in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). The bankruptcy court's interpretation of *Ron Pair* constitutes a legal question which we review de novo. See *In re Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir.1986) (citing *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1308 (5th Cir.1985)).

B. *The Interpretation of the Ron Pair Decision*

After a hearing on the motions for reconsideration, the bankruptcy court decided that the contract rate was not the correct rate of interest to be applied under §506(b) and that the federal

judgment interest rate was the proper rate to apply. Based on its interpretation of the Supreme Court's opinion in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989), the bankruptcy court concluded that the issue of interest was completely divorced from the existence of an agreement, and therefore, the agreement did not provide the applicable rate of interest. We find that the bankruptcy court incorrectly interpreted *Ron Pair*.

In *Ron Pair*, the Supreme Court held that §506(b) applied to all oversecured claims, consensual and nonconsensual. The decision resolved a split in authority over whether §506(b) applied only to claims arising under an agreement, or whether it applied to all oversecured claims, arising from consensual agreements or nonconsensual statutory liens. 3 COLLIER ON BANKRUPTCY P 506.05 at 506-42. Section 506(b)

provides that:

> [t]o the extent that an allowed secured claim is secured by property the value of which ... is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. §506(b). In *Ron Pair*, the Supreme Court analyzed the plain meaning of §506(b), finding that the phrase "interest on such claim" is not modified by the clause "provided for in the agreement," because " 'interest on such claim' is set aside by commas, and separate from the reference to fees, costs, and charges by the conjunctive words 'and any.'" *Ron Pair*, 109 S.Ct. at 1030. As a result, "interest on such claim" refers both to

consensual and nonconsensual claims. *Id.* When interpreting the *Ron Pair* decision, the bankruptcy court concluded that "[g]iving full effect to the Supreme Court's interpretation of that comma leads ineluctably to the conclusion that the entire issue of interest is completely divorced from either the existence or the content of any underlying agreement." *In re Laymon*, 117 B.R. 856, 858-59 (Bankr.W.D.Tex.1990). This conclusion is erroneous. The *Ron Pair* decision does not address the issue of what rate of interest is applied under §506(b). There is nothing in the *Ron Pair* decision that leads us to believe that the Supreme Court intended to speak to the rate of interest under §506(b).

C. *What Rate of Interest Applies Under §506(b)?*

Even though we hold that *Ron Pair* does not affect the rate of interest applied in §506(b), we still must determine what rate of interest applies in this

case. The Supreme Court "has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup v. Timm*, --- *U.S.* ---, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992). The legislative history of §506(b) does not refer to a rate of interest. 3 COLLIER ON BANKRUPTCY P 506.05, at 506-47. The language of §506(b) does not refer to a rate of interest. See 11 U.S.C. §506(b). Therefore, we must conclude that Congress did not intend for §506(b) of the Code to effect a major change in pre-Code practice concerning the rate of interest applied under the section. See *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 110 S.Ct. 2126, 2133, 109 L.Ed.2d 588 (1990) ("We will not read the Bankruptcy Code to erode past

bankruptcy practice absent a clear indication that Congress intended such a departure.").

Prior to the enactment of the Bankruptcy Code, courts applied a general rule that the accrual of interest on claims against the bankrupt estate was suspended from the date the petition was filed. See *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946). Yet, most courts recognized three exceptions to this rule. See *United States v. Bass*, 271 F.2d 129, 130 (9th Cir.1959). One of these exceptions was that post-petition interest was allowed when the security for a claim was worth more than the sum of principal and interest due, i.e. when the creditor was oversecured. See *In re Macomb Trailer Coach*, 200 F.2d 611, 613 (6th Cir.1953). When the Bankruptcy Code was enacted, §506(b) codified pre-Code law regarding this exception. *In re United Merchants and*

Manufacturers, Inc., 674 F.2d 134, 138 (2d Cir.1982). Since §506(b) does not speak to the rate of interest allowed under the section, we turn to pre-Code case law for the answer.

Prior to the enactment of the Code, the majority of courts utilized the contract rate of interest when allowing an oversecured creditor to collect post-petition interest pursuant to §506(b). 3 COLLIER ON BANKRUPTCY P 506.05, at 506-46. Therefore, we hold that when an oversecured creditor's claim arises from a contract, the contract provides the rate of post-petition interest. In this case, however, the contract included a 10% pre-default rate and an 18% default rate. Bradford claims that he is entitled to the 18% default rate.

Under pre-Code law, courts were "not required in all cases to apply a contractual default rate of interest in determining the amount of an 'allowed secured claim' within the meaning of [s 506(b)]." *In*

re Sheppley & Co., 62 B.R. 271 (Bankr.N.D.Iowa 1986) (discussing the following pre-Code cases: *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 67 S.Ct. 237, 91 L.Ed. 162 (1946); *American Surety Co. v. Sampsell*, 327 U.S. 269, 66 S.Ct. 571, 90 L.Ed. 663 (1946); *U.S. Trust Co. v. Zelle*, 191 F.2d 822 (8th Cir.1951), *cert. denied* 342 U.S. 944, 72 S.Ct. 558, 96 L.Ed. 703 (1952); *In re Black Ranches, Inc.*, 362 F.2d 8 (8th Cir.), *cert. denied sub nom., Black v. Strand*, 385 U.S. 990, 87 S.Ct. 595, 17 L.Ed.2d 450 (1966); *Ruskin v. Griffiths*, 269 F.2d 827 (2d Cir.1959), *cert. denied*, 361 U.S. 947, 80 S.Ct. 402, 4 L.Ed.2d 381 (1960)). Most courts took a flexible approach, recognizing situations in which "the higher rate would produce an inequitable or unconscionable result, so as to require disallowance thereof." *Sheppley*, 62 B.R. at 277. Accordingly, whether the 18% default rate, rather than the 10% pre-default rate, should apply

in this case must be decided by examining the equities involved in this bankruptcy proceeding.

Therefore, we REVERSE and REMAND to the district court for further proceedings consistent with this opinion.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

IN RE:	§	
WAYNE LAYMON,	§	
Debtor	§	
	§	
THERON BRADFORD,	§	
TRUSTEE,	§	
Appellant,	§	
	§	
v.	§	CIVIL ACTION NO.
	§	A-90-CA-1025
JAMES CROZIER,	§	
TRUSTEE,	§	
Appellee.	§	

O R D E R

This is an appeal from a final order of the United States Bankruptcy Court for the Western District of Texas denying the Appellant's request to apply the interest rate provided by contract rather than the interest rate applicable to federal judgments.

I. *Issues and Standard of Review*

Appellant presents the following issue:

Did the Bankruptcy Court err in limiting

interest on Appellant's claim to the federal judgment interest rate rather than the contractual rate provided in the Note, including any applicable contractual default rate?

There are no factual disputes; therefore, the Bankruptcy Court's ruling, being a conclusion of law, is subject to *de novo* review. *See In Re Texas Research, Inc.*, 862 F.2d 1161 (5th Cir. 1989).

II. *Statement of the Case*

On August 18, 1983, Wayne Laymon ("Laymon") executed a promissory note for $669,900.00 (the "Note") in favor of Theron Bradford, Trustee ("Bradford"). The Note was secured by a deed of trust on some real property. The terms of the Note provide for annual payments for four years, with a balloon payment due at the end of the fifth year, and for the accrual of 10% interest on any unpaid principal. The Note also provides for interest on matured, unpaid amounts

at the highest rate permitted by law -- which is 18% in this case.

The first payment on the Note was due on August 18, 1984, which Laymon failed to make. Instead, on September 4, 1984, Laymon filed a voluntary petition for bankruptcy under the provisions of Chapter 11 of the Bankruptcy Code. James Crozier ("Crozier") was subsequently appointed Chapter 11 Trustee in March of 1987, and made adequate protection payments to Bradford on behalf of the estate.

In May 1989, Bradford filed a motion requesting payment of interest, costs, and fees under 11 U.S.C. §506(b). He asserted that he was entitled to interest at the 18% penalty interest rate provided in the Note. After a hearing on the motion, the Bankruptcy Court entered an order denying the request for penalty interest, but found that Bradford did have an allowed secured claim of

$375,525.00, plus pre- and post-petition interest of $60,046.00 through May 15, 1989. The Bankruptcy Court held that interest continued to accrue at the contract rate of 10%.

Bradford filed a motion to reconsider, claiming that: (1) Bradford was entitled to recover the default rate under the Note, and (2) the adequate protection payments made to Bradford during the pendency of the bankruptcy proceeding should be applied to reduce interest instead of principal (in part because of the parties' stipulation that the claim of Bradford is oversecured). Crozier filed a cross-motion for reconsideration, asserting that the interest should be calculated at the legal federal judgment rate, not the contract or default rate. The Bankruptcy Court withdrew its prior order and ruled that the applicable interest rate was the federal judgment rate, rather than the contract or default rate.

III. *Discussion*

A review of the Bankruptcy Court's opinion, the briefs of the parties, and the applicable authority persuades the Court that the Bankruptcy Court's determination that the federal judgment rate is applicable should be affirmed.

Section 502(b)(2) of the Bankruptcy Code prohibits the accrual of interest on a debtor's obligations as of the date a petition for bankruptcy is filed. 11 U.S.C. §502(b)(2). An exception to this general rule is found in §506(b), which permits the holder of a fully secured claim to receive an award of post-petition interest up to the value of its collateral. 11 U.S.C. §506(b).[1] The Appellant

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[1] 11 U.S.C. §506(b) provides:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall

argues that §506(b) should be construed to permit recovery of whatever interest might be provided in a contract with the debtor. The Appellee argues that the applicable interest rate should be that for federal judgments, despite the presence of contract language providing for a different rate.

The Supreme Court has construed the clear language of §506(b) to indicate that an award of interest is separate and independent from "the agreement under which such claim arose." *In Re Ron Pair Enterprises, Inc.*, --- U.S. ---, 109 S.Ct. 1026, 1031 (1989). The language of *Ron Pair* persuades the Court that the award of interest in a case such as the present one does not depend upon

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be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs or charges provided for under the agreement under which such claim arose.

the provisions or the note or contract at issue. Further, for the reasons put forward in the Bankruptcy Court's opinion, the Court is persuaded that the application of the federal judgment rate was proper. Accordingly, it is

ORDERED that the Bankruptcy Court's opinion is AFFIRMED and this case is DISMISSED.

SIGNED this 21st day of March, 1991.

Walter S. Smith, Jr.
U. S. District Judge

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

IN RE:	§	
	§	
WAYNE LAYMON,		CASE NO. 84-11503-FM
	§	CHAPTER 11
DEBTOR.	§	

ORDER ON MOTION TO RECONSIDER AND
TRUSTEE'S CROSS-MOTION TO
RECONSIDER ORDER ON
MOTION FOR AWARD OF INTEREST, COSTS
AND FEES UNDER SECTION 506(b)

CAME ON to be considered the Motion to Reconsider filed by Theron Bradford, Trustee, and the Trustee's Cross-Motion to Reconsider filed by James Crozier, the Chapter 11 Trustee. The court finds that it should grant the Cross-Motion to Reconsider filed by James Crozier, Trustee, and should deny the Motion to Reconsider filed by Theron Bradford, Trustee. The court has made findings of fact and conclusions of law in its Decision on Motion to Reconsider dated June 27, 1990, which findings are incorporated by reference.

The court makes the following additional findings:

1. The court's order on Motion for Award of Interest, Costs and Fees Under §506(b) entered on July 7, 1989 should be vacated.

2. Theron Bradford, Trustee, is entitled to recover interest on his over-secured claim at the federal judgment rate, as such rate varies from time to time. A listing of the rates in effect during the pendency of this case through June 29, 1990 is attached hereto as Exhibit A and is incorporated by reference.

3. Theron Bradford, Trustee, is not entitled to interest upon interest.

4. Theron Bradford, trustee, is not entitled to adequate protection payments and James Crozier, Trustee, is hereby authorized to discontinue such payments. To the extent that Theron Bradford, Trustee, has received payments denominated as "adequate protection," those

payments will be treated as §506(b) interest payments. To the extent that payments previously made exceed post-petition interest accrual at the federal judgment rate, such payments shall be applied, as of the date of receipt by the creditor, to principal and then to pre-petition interest.

5. Attached hereto as Exhibit B is an accounting of the interest upon the Theron Bradford, Trustee, debt, the payments received by Theron Bradford, Trustee, during the pendency of this case, and application of such payments. Exhibit B is incorporated herein by reference.

It is therefore ordered as follows:

1. This court's Order on Motion for award of Interest, Costs and Fees Under §506(b) is hereby vacated.

2. The current balance of the claim of Theron Bradford, Trustee, shall be computed by calculating interest at rates and for the periods set

forth in Exhibit "A" attached hereto from and after September 4, 1984. All payments previously received by Theron Bradford, Trustee, shall be applied as of the date of receipt first to post-petition interest, then to principal and finally to pre-petition interest. Such claim will continue to accrue interest upon principal at the federal judgment rate, as published from time to time by the Administrative Office or the United States Court.

3. All costs, fees and expenses requested by Theron Bradford, Trustee, are denied without prejudice. The court shall retain the issue of what attorney's fees should be awarded until a proper fee application complying with the First Colonial standards is submitted and approved by the court.

SIGNED this 9th day of October, 1990.

Leif Clark
U.S. Bankruptcy Judge

EXHIBITS A AND B CONTAIN
TABULAR MATERIAL WHICH CANNOT
BE REPRODUCED IN THE PRESENT FORMAT

In re Wayne LAYMON, Debtor.

Bankruptcy No. 84-11503-A11.

United States Bankruptcy Court,

W.D. Texas,

Austin Division.

June 27, 1990.

DECISION ON MOTION TO RECONSIDER

LEIF M. CLARK, Bankruptcy Judge.

This decision addresses the appropriate rate of interest to award to an oversecured creditor under Section 506(b) of the Bankruptcy Code. The creditor wants the court to look to the contract and apply the applicable rate based on that agreement. The creditor adds that, because the debtor was in default when the bankruptcy was filed, the applicable rate is the 18% -default rate of interest. The trustee retorts that, after the U.S. Supreme

Court's decision in *Ron Pair*,[2] the contract is irrelevant to this question, so the court should look elsewhere for the appropriate rate. The trustee suggests the federal judgment interest rate.

Background

On August 18, 1983, Wayne Laymon ("Laymon") executed a promissory note for $669,900.00 in favor of Theron Bradford, Trustee ("Bradford"), secured by a Deed of Trust on some real property. The note called for annual payments for four years with a balloon payment due at the end of the fifth year on August 24, 1988. Contract interest of 10% accrues on unpaid principal. The note also provides for interest on matured, unpaid amounts at the highest rate permitted by law--which is 18% in this case. Laymon filed bankruptcy on

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[2]In re Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989).

September 4, 1984 without having made the first payment on the note, which had come due a few weeks before. The debtor made two "adequate protection" payments to Bradford. James Crozier ("Crozier") was subsequently appointed Chapter 11 Trustee in the case in March 1987. He also made adequate protection payments to Bradford on behalf of the estate. In May 1989, Bradford filed a motion requesting payment of interest, costs, and fees under 11 U.S.C. §506(b). He asserted that he was entitled to interest at the 18% penalty interest rate. After a hearing on the motion, the court entered an order denying the request for penalty interest, but found that Bradford did have an allowed secured claim of $375,525.00, plus pre- and post-petition interest of $60,046.00 through May 15, 1989. The court held that interest continued to accrue at the contract rate (10%). Bradford filed a motion to reconsider this order. Bradford claims that (i)

Bradford is entitled to recover a "default rate of interest" under the Note, and that (ii) the adequate protection payments made to Bradford during the pendency of this case should be applied to reduce interest instead of principal (in part because of the parties' stipulation that the claim of Bradford is oversecured).[3] Crozier filed a Cross Motion to Reconsider, asserting that interest should be calculated at the legal judgment rate, not the contract or default rate, and that interest upon interest should not be allowed.

Discussion

Under the Bankruptcy Code, interest effectively

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[3]Bradford also candidly reminds the court in his motion for reconsideration that the parties had previously stipulated that the Note to Bradford had not been declared in default as of the date of filing of the petition. The court's order found to the contrary.

ceases to accrue on a debtor's obligations as of the filing of a petition because any claim for unmatured interest beyond the filing date is disallowed as a claim against the estate. See 11 U.S.C. §502(b)(2); *In re Bates*, 58 B.R. 915, 916 (Bankr.W.D.Tenn.1986) (citing numerous cases). This general prohibition on the recovery of post-petition interest is a codification of case law developed under the Bankruptcy Act. See *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 167, 67 S.Ct. 237, 239-40, 91 L.Ed. 162 (1947).[4]

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[4]Three exceptions to this general prohibition were permitted under the case law developed under the Act. First, if the estate ultimately proved to be solvent, unsecured creditors could recover interest on their claims.

Second, if a secured creditor's collateral was income-producing, the creditor was entitled to receive interest post-petition. Third, where the amount of the secured creditor's (continued...)

Section 506(b) is one of the Bankruptcy Code's exceptions to Section 502(b)(2)'s proscription on the allowance of post-petition interest against the estate (the other is 726(a)(5), discussed infra). The section permits the holder of a fully secured claim to receive an award of post-petition interest up to the value of its collateral. 11 U.S.C. §506(b); *In re Hildreth*, 43 B.R. 721, 722 (Bankr.D.Idaho 1984).[5]

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[4](...continued)
security was sufficient to satisfy both the principal and interest due on the secured claim, the creditor might be paid regular interest payments during the case. See Securities Investor Protection Corp. v. Ambassador Church Finance Development Group, 788 F.2d 1208, 1211 n. 4 (6th Cir. 1986); In re Boston & Maine Corp., 719 F.2d 493, 496 (1st Cir. 1983).

[5]11 U.S.C. §506(b) provides:

(b) To the extent that an allowed
(continued...)

A. *In re Ron Pair Enterprises, Inc.*

Section 506(b) has generated a good deal of litigation over its interpretation. Prior to the Supreme Court's 1989 decision in *In re Ron Pair Enterprises, Inc.*, courts were divided over whether

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[5](...continued)
secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs or charges provided for under the agreement under which such claim arose.

§506(b) governs only interest accruing between the date of the bankruptcy petition and the date of distribution to the creditor. Prior to filing, the interest rate on a claim is governed by applicable non-bankruptcy law (whether contractual or statutory) and simply represents part of the pre-petition claims.

the section authorized interest only to those oversecured creditors that had a prepetition consensual agreement calling for interest.[6] In *In re*

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[6]The majority position was that postpetition interest could be recovered on all oversecured claims, whether consensual or nonconsensual.

See e.g., *In re Young*, 61 B.R. 150 (Bankr.S.D.Ind.1986); *In re Henzler Mfg. Co.*, 55 B.R. 194 (Bankr.N.D.Oh.1985); *In re Loveridge Mach.& Tool Co., Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983); *In re Hoffman*, 28 B.R. 503 (Bankr.D.Md. 1983). Those courts generally relied on the fact that the phrase "interest on such claim" is separated by commas from the remaining reference to fees, costs and charges, indicating that the award of interest, unlike the recovery of attorneys fees and other charges, is not dependent on the existence of an "agreement". See *In re Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 1027, 103 L.Ed.2d 1290 (1989) and authorities cited therein.

The minority position that Section 506(b) limits recovery of postpetition interest to holders of consensual liens (continued...)

Ron Pair Enterprises, Inc., the Supreme Court settled the question, ruling that the recovery of postpetition interest under Section 506(b) is not limited to holders of consensual liens. *In re Ron*

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[6](...continued)
reads the phrase "provided for under the agreement under which such claim arose" to modify the words "interest on such claim" as well as the words "any reasonable fees, costs, or charges." See, *e.g.*, *In re Newbury Cafe, Inc.*, 841 F.2d 20 (1st Cir. 1988); *In re Nevada Environmental Landfill*, 81 B.R. 55 (Bankr.D.Nev. 1987). These cases refused to impute significant congressional intent to the placement of a mere comma. See *In re Ron Pair Enterprises, Inc.*, 109 S.C. at 1027. They also relied on pre-Code authority to the effect that the exception applied only to consensual liens. See *In re Newbury Cafe*, 841 F.2d at 22.

Pair Enterprises, Inc., 109 S.Ct. at 1026. The Court reasoned that the phrase "interest on such claim" is set off by commas, while the reference to fees, costs, and charges follows the comma and the conjunctive words "and any". The interest award thus stands independent of the reference to "the agreement under which such claim arose." *Id.* at 1031. The Court thereby pried the Section 506(b) interest award free of any pre-existing agreement.

B. Cases decided under the Code regarding the appropriate rate of interest to be paid pursuant to Section 506(b) offer little guidance

Left unanswered (because it was not an issue in the case) was whether, assuming there is an agreement underlying the claim, the court should look to that agreement to decide on the rate of interest to be allowed an oversecured creditor.[7]

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[7]Ron Pair involved the award of interest on a tax claim (continued...)

Giving full effect to the Supreme Court's interpretation of that comma leads ineluctably to the conclusion that the entire issue of interest is completely divorced from either the existence or the content of any underlying agreement.

Case law prior to *Ron Pair* is of little assistance in resolving the issue, as most courts confronting the rate question for consensual lienholders had settled

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[7](...continued)
which arose under a state statute. In the case of nonconsensual liens (usually tax liens), courts have usually used specified rates of interest. See e.g., *Matter of Isley*, 104 B.R. 673 (Bankr.D.N.J.1989); *In re Davison*, 106 B.R. 1021 (Bankr.D.Neb.1989) (statutory rate); *In re Lapiana*, 100 B.R. 998 (N.D.Ill.1989) (rate specified in I.R.C. §6621); *In re Krump*, 89 B.R. 821, 825 (Bankr.S.D.1988); *In re Henzler Mfg. Co.*, 55 B.R. 194, 197 (Bankr.E.D.Ohio 1985) (rate specified in I.R.C. §6621); *In re Hoffman*, 28 B.R. 503, 508 (Bankr.Md.1983) (rate specified in I.R.C. §6621).

on the contract rate by relying (explicitly or implicitly) on the statute's reference to "that amount provided for under the agreement under which such claim arose." See e.g., *In re Bates*, 58 B.R. 915 (Bankr.W.D.Tenn.1986); *In re Matter of Johnston*, 44 B.R. 667 (Bankr.W.D.Miss.1984); *In re Loveridge Machine & Tool Co., Inc.*, 36 B.R. 159 (Bankr.D.Utah 1983).[8] After *Ron Pair*, that logic is considerably less persuasive. Once the comma is given effect, leaping past it to the statute's reference to "the agreement" is no longer permissible.

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[8]The *Loveridge* court found that since §506(b) treats interest on "an allowed secured claim" and such a claim may arise from contractual or noncontractual obligations, a claim arising from either type of lien is entitled to interest under the section. Loveridge, 36 B.R. at 162. The court, applying equitable principles, added that using the specified contract rate avoids favoritism and prevents a windfall to either party. *Id.* at 163.

Two courts allowed the use of non-contractual rates of interest even though there was a contract, relying ostensibly on "equitable principles." *In re Minguey*, 10 B.R. 806 (Bankr.W.D.Wisc.1981) (applying the rate of 10% on equitable principles); *In re Marx*, 11 B.R. 819 (Bankr.S.D.Ohio E.D.1981) (legal rate). The precedential value of these decisions is somewhat flawed, however, as both cases were using Section 506(b) for guidance in setting the appropriate discount rate for paying a secured claim under a Chapter 13 plan. See 3 Collier on Bankruptcy P 506.05 (15th ed. 1985). Some courts employ circular logic, presuming the inviolability of the contract rate to find that rate inviolable. See, e.g., *In re Gladdin*, 107 B.R. 803, 805 (Bankr.M.D.Ga.1989) (finding the contract rate applicable because Section 506(b) does not expressly authorize a bankruptcy court to modify that rate); *In re Melbell Associates, Inc.*, 99 B.R. 31

(Bankr.E.D.Cal.1989); See *In re Loveridge Machine & Tool Co., Inc.*, 36 B.R. 159, 163 (Bankr.D.Utah 1983) (holding a contract rate appropriate because rejection of that rate would result in a windfall to the debtor or creditor depending on the rate selected). Because the very question to be resolved is to what the word "interest" refers, presuming a reference to the contract rate to conclude it refers to the contract rate is of course no assistance whatsoever.

C. Case law construing Section 726(a)(5): A helpful analogy

The Code contains one other exception to the general prohibition on postpetition interest on claims. 11 U.S.C. §726(a)(5).[9] A closer inspection

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[9]11 U.S.C. §726 provides in relevant part:

(a) Except as provided in section 510 of this title, property of the estate shall be

(continued...)

of that section elucidates the issue at hand. Under Section 726(a)(5), if a Chapter 7 estate ultimately proves to be solvent, all holders of allowed unsecured claims are paid interest on their claims before any proceeds of the liquidation are returned to the debtor. The section directs payment of this interest "at the legal rate". 11 U.S.C. §726(a)(5), (6). By inquiring after the meaning of this expression and the purpose for its use, we may be able to learn how best to interpret the award of interest in Section 506(b).

The Section 726 distribution is the contemplated

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[9](...continued)
distributed--

. . . . .

(5) fifth, in payment of interest at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection.

last step in the overall liquidation process of a Chapter 7 case. By the time the trustee reaches this stage, she is expected to have first disposed of any property subject to third party interests (e.g., property subject to liens, property held in common with another), either by selling the property, returning it to third parties, or abandoning it to the debtor, and to have reduced all remaining interests in property to cash. 11 U.S.C. §725. The Section 726 distribution process does not begin until all property has been converted to cash and all secured claims have been satisfied.

1. *The award of post-petition interest is a matter within the discretion of the federal court, and arises under federal law*

As a general proposition, "when and under what circumstances federal courts will allow interest on claims against debtors' estates ... has long been decided by federal law." *Vanston Bondholders*

Protective Committee v. Green, 329 U.S. 156, 67 S.Ct. 237, 240, 91 L.Ed. 162 (1947). In *Vanston*, the Supreme Court stated that "[i]t is manifest that the touchstone of each decision on the allowance of interest in bankruptcy, receivership, and reorganization has been a balance of the equities between creditor and creditor or between creditors and the debtor." *Id.* 67 S.Ct. at 241. As an adjunct to this principle, the Code expressly directs that, absent the affirmative intervention of the statute or the court, post-petition interest on all obligations of the debtor will not be allowed after the filing of the bankruptcy. 11 U.S.C. §502(b)(2).

> The federal bankruptcy rule, derived from English laws, provides that in the case of insolvent debtors interest, whether stipulated in a contract or not, stops at the moment the petition in bankruptcy is filed.

Debentureholders Protective Committee v. Continental Investment Corp., 679 F.2d 264, 268 (1st Cir.1982), *cert. denied*, 459 U.S. 894, 103 S.Ct. 192, 74 L.Ed.2d 155 (1982), citing, *inter alia*, *Sexton v. Dreyfus*, 219 U.S. 339, 344, 31 S.Ct. 256, 257, 55 L.Ed. 244 (1911). The First Circuit noted two reasons for this rule:

> (1) Interest is a penalty or damages assessed for detention of money *by the debtor*, so it is not appropriate to assess that penalty against other creditors who are not to blame for the detention.
>
> (2) It is the *court*, not the debtor, that is doing the "detaining" post-petition.

Id. at 269.

We thus come upon the first of three important principles which should guide the decision of this

matter: The justification for interest, if it is to be paid at all, is in compensation for the detention of money occasioned by the bankruptcy case itself, a detention visited equally on all creditors of the bankruptcy estate by a process operating under the exclusive auspices of the federal judicial system, and a detention not directly related to the prepetition agreements the debtor struck with its creditors. The obligation is the bankruptcy estate's, not the debtor's.

2. *Compensation for delay before returning any surplus to the debtor*

Section 726(a)(5) represents a statement of basic bankruptcy policy: in fairness, the debtor should not be permitted to enjoy this fund at the expense of the intended primary beneficiaries of the bankruptcy process, the debtor's creditors. Equity thus mandates that the debtor first pay his creditors for this delay cost out of this fund, before

receiving the balance. H.Rep. 595, 95th Congress, 1st Session 352 (1977), U.S.Code Cong. & Admin.News 1978, p. 5787; *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 67 S.Ct. 237, 240, 91 L.Ed. 162; *Debentureholders Protective Committee v. Continental Investment Corp.*, 679 F.2d 264, 269 (1st Cir.1982), cert denied, 459 U.S. 894, 103 S.Ct. 192, 74 L.Ed.2d 155 (1982); see also *In re Shaffer Furniture Co.*, 68 B.R. 827, 830 (Bankr.E.D.Pa.1987); *In re Beverly Hills Bancorp*, 752 F.2d 1334, 1339 (9th Cir.1984).

> [T]he rule is in harmony with the settled English and American law that when an alleged bankrupt is proved solvent, the creditors are entitled to receive post-petition interest before any surplus reverts to the debtor.

Continental Investment Corp., 679 F.2d at 289; See 11 U.S.C. §726(a)(6); see also *New York v. Saper*,

336 U.S. 328, 330 n. 7, 69 S.Ct. 554, 555 n. 7, 93 L.Ed. 710 (1949); *U.S. v. Bass*, 271 F.2d 129, 130 (9th Cir.1959); *Littleton v. Kincaid*, 179 F.2d 848, 27 A.L.R.2d 572 (4th Cir.1950).[10] We thus learn the second important principle that speaks to the resolution of the question: If there is a surplus, creditors should be compensated for the delay occasioned by bankruptcy before any balance is returned to the debtor.

3. *The underlying purpose of any bankruptcy system is the ratable, equitable distribution of assets among creditors of the estate*

The general purpose of a bankruptcy statute is the equitable distribution of the debtor's assets among the debtor's creditors. 3 Collier on Bankruptcy P 502.02[2] at 502-29 *et seq.* (15th ed.

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[10]The rationale for this payment is independent of claims allowance under §502 (addressed by §726(a)(2)-(4)).

1981). A number of significant consequences flow from this simple statement of the obvious. First, bankruptcy statutes should be interpreted to give effect to this underlying principle. Second, all similarly situated creditors should be similarly treated. Third, creditors should not be preferred absent special legal or equitable considerations warranting preferential treatment. When this principle is applied to the interest question, one outcome is that similarly situated creditors equally affected by the circumstance which warrants the payment of interest (i.e., the delay caused by the bankruptcy) should be equally compensated on a pro rata basis. In other words, all such creditors should be paid at the same rate of interest, applied to their claims as allowed under Section 502. In this way, the interest compensation paid under Section 726(a)(5) is distributed on the same basis as the assets distributed in satisfaction of allowed

claims under Section 726(a)(2)-(4). There is no good reason why one unsecured creditor should receive a greater share of the Section 726(a)(5) "pie" solely by virtue of its prepetition contract interest rate when the rationale for paying interest under Section 726(a)(5) has nothing to do with the prepetition contracts of the debtor. We thus learn from this analysis the third basic principle which should inform our decision-making on the issue at hand: Postpetition interest awards should be consistent with the principle of equitable, ratable distribution of estate assets to estate creditors.

4. *Applying the three principles to the interpretation of Section 726(a)(5)-- what is the "legal rate"*

Section 726(a)(5) directs that interest be paid to unsecured creditors of a solvent estate at "the legal rate." The foregoing three principles give direction to what that rate refers.

We first can safely say that it does not refer to the respective contract rates of the various unsecured creditors, because that would fly in the face of equitable distribution of assets. Furthermore, the principle that postpetition interest is controlled by federal law militates against state-law contract rates. The principle that creditors should be paid in full before the debtor is entitled to any of the surplus supports the use of a contract rate, but the explicit language of the statute will not. The statute refers to the legal rate, applied equally to all unsecured creditors, indicating the use of a single rate ratably applied to all allowed claims. Finally, the interest contemplated under the creditor's contract is expressly excluded from allowance by Section 502(b)(2). Whatever is paid under Section 726(a)(5), it is certainly not the interest accruing under the prepetition contract. *But see* C. Fortgang & L. King, *The 1978 Bankruptcy Code: Some Wrong*

Policy Decisions, 56 N.Y.U.L.Rev. 1148, 1152 (1981).[11]

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[11] Ordinarily, bankruptcy laws and rules affect the rights of creditors in favor of or at the expense of other creditors by changing the rules that would prevail outside a bankruptcy court in order to more equitably allocate the values of the debtor among the creditors. The alteration of a valid, binding, and legal contractual obligation, so that the debtor retains nonexempt property prior to the payment of its valid debts, is a legally startling and somewhat appalling result.... There does not appear to be any substantial policy consideration that would sanction this result.

Id. Messrs. Fortgang and King would return to the arrangement used by some courts under the Act, "which routinely awarded postpetition interest at the contract rate in appropriate circumstances." *Id.* at 1152 n. 18 (citations omitted). The approach may have much to recommend it in

(continued...)

The state law judgment rate is used by some courts, without much analysis. See, e.g., *In re Shaffer Furniture Co.*, 68 B.R. 827, 830 (Bankr.E.D.Pa.1987); *In re Boyer*, 90 B.R. 200, 201 (Bankr.D.S.C.1988); *In re Adcom, Inc.*, 89 B.R. 2, 2 (D.Mass.1988). That rate faces some difficulties

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[11](...continued)
the narrow circumstance in which there is so much of a surplus that, after ratable distribution of interest at a court-set "legal rate," monies remain to compensate for interest which otherwise would have accrued under the terms of the contracts of the unsecured creditors. Unfortunately, as a *routine* approach, it also runs into a statutory roadblock--the prohibition on contract interest post-petition in Section 502(b)(2).

The premise of the law review article was that the Code as drafted is either premised on wrong policy decisions or generates unintended and unanticipated consequences. *Id.* at 1148. If the authors are correct, then it is up to Congress, not the court, to remedy the problem.

however. Again, the principle that the award of postpetition interest is a matter of federal law militates against using the judgment rate of a particular state, especially because the bankruptcy system is national in scope, affecting creditors with claims conceivably arising from multiple jurisdictions. Would the use of a New York judgment rate be appropriate in a New York bankruptcy where the creditor is in Texas and the contract contains a choice of law clause designating Texas law as controlling? Under what theory?

The federal judgment rate commends itself as a fair rate for purposes of Section 726(a)(5). See 28 U.S.C. §1961; *In re Goldblatt Bros.*, 61 B.R. 459, 466 (Bankr.N.D.Ill.1986); *In re A & L Properties*, 96 B.R. 287, 290 (C.D.Cal.1988). Its use would comport with two of the general principles discussed above, ratable distribution and use of federal law to decide a federal issue. In addition,

the federal judgment rate matches the analytical posture of claims vis-a-vis the federal bankruptcy. Upon bankruptcy, all claims against the estate are "deemed allowed" as of the filing (in the absence of a timely objection). 11 U.S.C. §502(a). From and after the petition date, creditor hold the equivalent of a federal judgment against estate assets, enforceable only in federal court. See 28 U.S.C. §1334(a) (original and exclusive jurisdiction over bankruptcy), §1334(d) (exclusive jurisdiction over property of the estate); 28 U.S.C. §157(b)(2)(B) (claims adjudication a core proceeding); 11 U.S.C. §524(a) (discharge bars further assertion of prepetition claims against the debtor); 11 U.S.C. §362(a) (automatic stay of acts to collect claims against property of the estate); 11 U.S.C. §726 (distribution of assets in satisfaction of claims); 11 U.S.C. §1141 (confirmed plan binds all holders of claims against the debtor). Judgments entered in

adversary proceedings, including judgments rendered on nondischargeable claims, earn interest at the federal judgment rate. See *In re Southern Indus. Banking Corp.*, 87 B.R. 518, 520 (Bankr.E.D.Tenn.1988); see also *In re Goldblatt Bros.*, 61 B.R. 459, 466 (Bankr.N.D.Ill.1986). The rate is of course uniform nationally. Only the principle of not paying the debtor any surplus before creditor claims are paid in full remains unvindicated by the use of this federal rate. That problem might be easily remedied on a case by case basis, however, by a reliance on "equitable principles" as suggested in *Shaffer Furniture*. See *In re Shaffer Furniture Co.*, 68 B.R. 827, 830 (Bankr.E.D.Pa.1987); see also *In re Beverly Hills Bancorp*, 752 F.2d 1334, 1339 (9th Cir.1984) (decided under the Bankruptcy Act). In the rare case in which interest paid at the federal judgment rate failed to exhaust the surplus available, a

second "cut" could be taken to pay any deficiency between that rate and the contract rate of particular unsecured creditors. Creditors whose contract rate was lower than the federal rate would not be affected. In this way, the third principle could be honored without doing violence to the other two.

D. Applying the principles learned to the Section 506(b) question

The same guiding principles that led to the conclusion that "the legal rate" in Section 726(a)(5) should mean the federal judgment rate point to a similar conclusion for settling on the rate to be paid on the Section 506(b) award of "interest on such claim."

First, the same principle of compensation for delay imposed by the pendency of the bankruptcy case explains the basis for the provision of interest to secured creditors in this subsection. Cf. *In re*

Boston & Maine Corp., 719 F.2d 493, 496 (1st Cir.1983); *Matter of Walsh Construction, Inc.*, 669 F.2d 1325, 1330 (9th Cir.1982). We have already noted how the Supreme Court's decision in *Ron Pair* divorced the interest to be paid under the subsection from any underlying agreement by giving no effect to the comma following the phrase "interest on such claim." The House Report adds that:

> Subsection (b) codifies current law by entitling a creditor with an oversecured claim to any reasonable fees, costs, or charges provided under the agreement under which the claim arose. These fees, costs, and charges are secured claims to the extent that the value of the collateral exceeds the amount of the underlying claim.

H.Rep. No. 595, 95th Cong., 1st Sess. 356-57 (1977), U.S.Code Cong. & Admin.News 1978, p.

6312 (emphasis added). The "fees, costs and charges" discussed in the legislative history are on the opposite side of the comma from the interest clause. See 11 U.S.C. §506(b) ("interest on such claim, and any reasonable costs, fees, or charges provided for under the agreement"). Section 502(b)(2), meanwhile, affirmatively prohibits the recovery of contract interest post-petition as an allowed claim against estate assets. 11 U.S.C. §502(b)(2). Section 506(b) should not be read to "give back" what Section 502(b)(2) "takes away."[12]

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[12]A fundamental tenet of statutory construction is that "each part or section [of a statute] should be construed in connection with every other part or section so as to produce a harmonious whole. Thus, it is not proper to confine interpretation to the one section to be construed." 2A N. Singer, *Sutherland Statutory Construction* §46.05, at 90 (Rev. 4th ed. 1984 & Supp. 1985); see also *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 73 S.Ct. 227, 229, (continued...)

The interest contemplated under Section 506(b) is most sensibly construed as an equitable award arising under federal law, to compensate the oversecured creditor for the delay caused by the bankruptcy case itself. See *Vanston*, 67 S.Ct. at 240 (1947).

The principle of equitable, ratable distribution of assets among creditors also lends support to the use of the federal rate in computing Section 506(b) interest awards. Any equity over and above the creditor's allowed secured claim belongs to the general pool of assets available to unsecured creditors. The competition for this asset is not between creditors and the debtor but between two different groups of creditors, secured and unsecured. The use of the federal judgment rate

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[12](...continued)
97 L.Ed. 260 (1952).

gives effect to Congress' intent that secured creditors have a "first claim" on that excess collateral value to compensate for the bankruptcy delay. At the same time, it prevents overreaching by the oversecured creditor. See *Johnson v. Norris*, 190 F. 459, 464 (5th Cir.1911) (payment of interest postbankruptcy should be based on equitable uniformity); see also *In re Leeds Homes, Inc.*, 222 F.Supp. 20, 33-34 (E.D.Tenn.1963) (contract interest should be disallowed when inequitable to other creditors). As the First Circuit noted in *Continental Investment Corporation*, the secured creditor's contractual interest rate arose from a deal struck with the debtor, not the unsecured creditors. *Debentureholders Protective Comm. v. Continental Investment Corp.*, 679 F.2d at 268-69. Because the rationale for paying postpetition interest is to compensate for the delay imposed by the bankruptcy process (which delay is visited equally

on all creditors), there is little justification for making unsecured creditors pay the secured creditor a rate of interest derived from a prepetition agreement to which they were not party. Use of the federal rate yields an "equitable solution" to the competing claims of the secured and unsecured creditor that also honors the principle of applying federal law to the payment of postpetition interest. See *Vanston*, 67 S.Ct. at 240. The court recognizes that one alternative analysis might be offered to support an award of contract interest to the oversecured creditor, on the theory that the equity in the collateral outside of bankruptcy would be vulnerable to that rate of interest. This analysis would make note that unsecured creditors trying to enforce a state law judgment against the equity in the collateral outside bankruptcy would take subject to that contract interest claim. The result, would go the logic, should be no different in

bankruptcy.

This argument does not account for the operation of Section 502, however. All creditors, including oversecured creditors, are deemed to have an allowed claim as of the bankruptcy filing which is the functional equivalent of a federal judgment against the estate's assets (absent a timely objection). 11 U.S.C. §502(a); 3 Collier on Bankruptcy P 502.01[1] (15th ed. 1987); see *Lewith v. Irving Trust Co.*, 67 F.2d 855 (2d Cir.1933) (allowance of claim has effect of judgment in bankruptcy proceeding); *In re McChesney*, 58 F.2d 340 (9th Cir.1931) (same); *International Agric. Corp. v. Cary*, 240 Fed. 101 (6th Cir.1917) (allowance of claim amounts to adjudication to that effect). The oversecured creditor's "federal judgment" would accrue interest at the federal judgment rate. See 28 U.S.C. §1961. Meanwhile, contract interest accruing postpetition is disallowed as a claim

against the estate by Section 502(b)(2).

State law entitlements are as a general principle suspended in the interests of an equitable distribution of assets in accordance with the Bankruptcy Code's scheme of entitlements. See 3 *Collier on Bankruptcy*, P 502.2 at 502-31 (15th ed. 1985). That is not a result that shocks the conscience of this court. To the contrary, it is entirely consistent with the Code's function of superimposing a federal entitlement scheme which pre-empts state law in service to the federal enactment's goal of promulgating a uniform system of laws respecting bankruptcy.

CONCLUSION

For the foregoing reasons, it is the conclusion of this court that, when computing the interest to be award to an oversecured creditor under Section 506(b), a court should apply the federal judgment rate applicable to the period during which

postpetition interest has accrued. Neither the prepetition contract rate nor the prepetition default rate provided under the contract should control the interest rate to be paid under Section 506(b). Again, there may be extraordinary circumstances which would dictate the payment of some additional amount perhaps approaching the contract rate. See *In re Shaffer Furniture Co.*, *supra*. Those circumstances are not present here, however. For the reasons which led this court to settle on the federal judgment rate, the court also concludes that, in equity, interest on interest should not, as a general rule, be permitted under Section 506(b). As the Supreme Court opined in *Vanston*, such an award is "not in accord with principles of equitable distribution in bankruptcy." *Vanston*, 67 S.Ct. at 240. The facts of this case do not present any exceptional circumstances which would warrant deviation from this rule. Because we have found

that resort to the prepetition contract rate of interest is inappropriate, we do not reach the question whether a contractual default rate would ever be an appropriate interest award under Section 506(b). The clear indication is that only the most unusual circumstances would ever justify its use.

The court also notes that the payment of interest under Section 506(b) has antecedents entirely independent from the payment of "adequate protection" to the secured creditor pursuant to Sections 362(d)(1) or 363(e). See *University Savings Assoc. of Houston, Texas v. Timbers of Inwood Forest, Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 631-32, 98 L.Ed.2d 740 (1987). The oversecured creditor receives interest because, like the unsecured creditor of a solvent estate, it enjoys the good fortune of having more than enough property with which to satisfy its claims. It will of necessity not be entitled to "adequate protection" because its

allowed secured claim has never been imperiled by the deterioration in value of its collateral.[13] In this case, the creditor's allowed secured claim has never been in danger. To the extent it has received payments denominated as "adequate protection," those payments will be treated as Section 506(b) interest payments. The estate will be liable for any shortfall. The creditor must repay any windfall.

The Chapter 11 Trustee is directed to prepare a form of order in conformity with this decision, in which the applicable federal judgment rate applied to the allowed secured claim of Bradford is computed.

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[13]It is conceivable that an oversecured creditor might request adequate protection to assure the preservation of an equity cushion sufficient to cover its claim to Section 506(b) interest.

No. 92-312

In The

Supreme Court of the United States

October Term, 1992

JAMES E. CROZIER, CHAPTER 11 TRUSTEE,
Petitioner,

v.

THERON BRADFORD, TRUSTEE,
Respondent.

Petition For Writ of Certiorari To The Fifth Circuit Court of Appeals

RESPONDENT'S BRIEF IN OPPOSITION

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STATUTORY PROVISIONS

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11 USC § 1124(i)

Impairment of claims or interests. Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan--

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interests;

11 USC § 1129(a)(9)(C)

Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--

(C) with respect to a claim of a kind specified in section 507(a)(7) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

11 USC § 1322(b)(2)

(b) Subject to subsections (a) and (c) of this section, the plan may--

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

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RESPONDENT'S BRIEF IN OPPOSITION

TO THE HONORABLE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The Respondent, Theron Bradford, respectfully requests that this Court deny the Petition for Writ of Certiorari submitted by the Petitioner, James E. Crozier.

SUMMARY OF ARGUMENT

Resolution of this appeal requires the reviewing court to discern Congressional intent with respect to the interest rate to be allowed under 11 USC § 506(b). The statutory language provides only that interest shall be allowed to oversecured creditors, without specifying an interest rate. The legislative history fails to address the issue also. The Fifth Circuit, therefore, turned to pre-Code practice to determine whether any substantial change is required based upon the language of § 506(b). The Fifth Circuit correctly held that under the Act, the majority of courts held that the contract rate of interest applied and that nothing in the Bankruptcy Code or its legislative history was intended to change that rule.

1. THE PETITION FAILS TO SATISFY SUPREME COURT RULE 10.1(C) AS THERE ARE NO SPECIAL AND IMPORTANT REASONS EVIDENT IN THIS CASE.

Petitioner seeks review of the opinion of the Fifth Circuit Court of Appeals pursuant to Supreme Court Rule 10.1(c), which provides:

1. A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor. The following, while neither controlling nor fully measuring the Court's discretion, indicate the character of reasons that will be considered:

> When a state court or a United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

Petitioner fails to establish that there are ". . .special and important reasons. . ." for review by this Court, or that this is ". . .an important question of federal law which has not been, but should be, settled by this Court. . . ." Petitioner does not contend that the opinion of the Fifth Circuit ". . .conflicts with applicable decisions of this Court."

Petitioner correctly cites the only Circuit Court of Appeals decisions which have considered this issue, Matter of Laymon, 958 F.2d 72 (5th Cir. 1992) reh. den. 964 F.2d 1145 and In re

Anderson, 883 F.2d 834 (9th Cir. 1987), both of which hold that the contract rate should apply under 11 U.S.C. § 506(b). No conflict exists among the circuits. Although Petitioner acknowledges this lack of conflict at the circuit level, it cites this Court to "a division among the lower Courts." Petition, p. 16. Divisions at the Bankruptcy Court level are insufficient to justify review by this Court. In addition, the "division" may not be as clear as Petitioner appears to believe, as the cases which he cites illustrate a clear trend. First, more cases have selected the contract rate than any other rate. At pages 16 and 17 of his Petition, he cites six cases holding the contract rate to be proper and two cases each holding the federal judgment rate, market rate, and legal rate to be proper. Second, more recent cases have tended to select the contract rate over other rates. The contract rate cases cited by Petitioner are dated 1992, 1987, 1989, 1986, 1986 and 1983. The market rate cases are dated 1987 and 1982. The legal rate cases are dated 1982 and 1981. The federal judgment rate cases, one of which is the opinion overruled by the Fifth Circuit in this case, are dated 1990 and 1992. (It is, perhaps, significant that the other case was written

by the same bankruptcy judge who wrote In re Laymon, 117 B.R. 856 (Bankr. W.D.Tex. 1980), and cites his opinion in Laymon as controlling.) Even this cursory review establishes the trend that the majority of recent cases have held that the contract rate of interest is the appropriate rate under 11 USC § 506(b).

Although Petitioner contends that this Court should review this case to interpret § 506(b) in light of its prior rulings in United States v. Ron Pair Enterprises, Inc., 109 S.Ct. 1026 (1989) and Dewsnup v. Timm, 112 S.Ct. 773 (1992), Petition, p. 14, he does not contend that the Fifth Circuit's opinion conflicts with either of the cited opinions of this Court. Given the lack of conflict with opinions of this Court and the lack of conflict among the Circuits, this matter does not fit the "special and important reasons" standard of Supreme Court Rule 10.1(c).

2. THE LANGUAGE OF § 506(B) DOES NOT ADDRESS THE ISSUE OF THE RATE OF INTEREST TO BE ALLOWED TO OVERSECURED CREDITORS.

Petitioner correctly contends that the language of § 506(b) and the legislative history are silent as to the rate of interest to be

allowed to oversecured creditors. Petitioner promptly resorts to an analysis of other Code sections which allow interest in order to determine where § 506 fits in a statutory scheme. Petitioner incorrectly contends that because § 502(b)(2) disallows claims for post-petition interest, no reference may thereafter be made to the contract. Petition, p. 19. Nothing in the language of § 502(b)(2) precludes allowance of interest at the contract rate under § 506(b). Allowance of interest to oversecured creditors is an exception to the general prohibition against allowance of post-petition interest.

Petitioner further opines that because the Bankruptcy Code "thoroughly regulates and modifies recovery" of interest in bankruptcy cases, any reference to non-bankruptcy entitlements is precluded. Petition, pp. 25-26. The fallacy in this analysis is apparent from a review of the Code sections dealing with interest. Each of the Code sections which provide for payment of interest in the context of confirmation of a plan of reorganization provide that a creditor shall receive, on account of its claim, payments ". . .of a value, as of the effective date of the plan. . ." of the amount of the creditors claim. See, § 1129(a)(9)(c), § 1129(b)(2)(A)(i)(II),

§ 1129(b)(2)(B)(i), § 1225(a)(5)(B)(ii), and § 1325(a)(5)(B)(ii). Petitioner states that these Code sections require payment of interest at a "market rate." Petition, p.26 Although "market rate" is not the standard stated in the statute, Respondent agrees that the vast majority of courts which have addressed the issue have adopted market rate as the standard.

Petitioner inappropriately cites § 1124(1) and 1322(b)(2) in contending that when Congress intended to leave non-bankruptcy interest entitlements intact, it did so with specific language. First, neither of the cited sections deals specifically with (or even mentions) allowance or rates of interest. Both sections deal with claims which are not modified in any form, including terms and length of repayment, and treatment of security, as well as interest. Second, each of these sections are more appropriately cited for Respondents position. In both instances, Congress has failed to specify a rate of interest other than that which would otherwise apply, and creditors are allowed to retain their non-bankruptcy entitlements. As Congress has demonstrated its ability to clearly abrogate such entitlements when it so intends, its failure to clearly

abrogate non-bankruptcy entitlements to interest in § 506(b) should be considered evidence that it intended that they be retained.

3. THE MAJORITY RULE UNDER THE BANKRUPTCY ACT PROVIDED FOR ALLOWANCE OF INTEREST AT THE CONTRACT RATE AND NOTHING IN THE BANKRUPTCY CODE CHANGES THAT RULE.

Petitioner's second ground for reversal, that historical practice under the Bankruptcy Act does not require application of the contract rate under § 506(b), simply ignores a clear majority rule. Petitioner first contends that because Congress made several changes in treatment of secured creditors regarding which there is no legislative history, the presumption that Congress would always make its intentions clear is rebutted. Petitioner offers as an example claims for attorneys fees under the Act and Code. Petitioner correctly states that under the Act recovery of attorneys fees was generally held to be a matter of state law, and there was no applicable standard of reasonableness. Petition, pp. 36-8. Under § 506(b), however, recovery of attorneys must be provided for in the agreement and must be reasonable. Petitioner trumpets the omission

of any legislative history on this issue as it constitutes a substantial change from pre-Code practice. The lack of legislative history is meaningless in this instance, however, as the change in practice is articulated in the plain language of the statute. Petitioner's example simply fails to prove his point. In fact the converse is true. With respect to attorney's fees, the change in practice is explicit. With respect to interest, the Code simply provides that it be allowed. Since no interest rate is specified, the Court must consider the context in which the statute was enacted.

Petitioner's contention that Act decisions regarding the rate of interest to be allowed are not uniform fails to recognize a clear majority rule that interest be allowed at the contract rate. This rule is evidenced by the cases cited in the Petition. Petition pp. 39-40. Petitioner further notes that several of the contract rate cases decided under the Act were based upon an Act provision which prohibited modification of liens and contends that such analysis is no longer valid because Congress changed the law in enacting the bankruptcy Code to allow modification of liens. Again Petitioner's argument misses the point. When Congress elected to change the law

regarding lien modification, that intention was made clear by specific statutory language. If Congress had also intended to change common practice regarding allowance of interest on oversecured claims, it would no doubt have made its intention equally clear.

Finally, Petitioner contends that this Court should look to § 726(a)(5) as it is the only other Code section dealing with post-petition, preconfirmation interest. Petition, p. 47. The analogy, however, is not analogous. § 726(a)(5) applies only in Chapter 7 cases. § 506(b) applies to cases under any Chapter under the Code. (This case is a Chapter 11, not a Chapter 7.) § 726(a)(5) applies only to solvent estates. § 506(b) applies regardless of whether the estate is solvent or insolvent. § 726(a)(5) applies only to unsecured claims. § 506(b) applies only to oversecured claims. § 726(a)(5) specifies that interest be paid at the "legal rate". § 506(b) does not mention, much less specify, an interest rate. § 726(a)(5) prevents unjust enrichment of the debtor by providing for an additional payment to creditors before any surplus in the estate is returned to the debtor. § 506(b) provides an oversecured creditor with the benefit of its bargain without regard to any benefit

or detriment to the debtor. Clearly, reference to § 726(a)(5) provides no assistance in deciding the rate of interest to be allowed pursuant to § 506(b).

4. THE "EQUITY BALANCING" APPROACH ADVOCATED BY PETITIONER IS AN HISTORICAL ANACHRONISM WHICH NO LONGER HAS ANY APPLICATION.

Petitioner's third ground for reversal, that allowance of interest in bankruptcy is a matter of federal law and deference to state law interest rates is not required, is based upon case law which has been superseded by the enactment of the Bankruptcy Code. Petitioner relies on Vanston Bondholders Protective Committee v. Green, 67 S.Ct. 237 (1946) and its progeny for the proposition that awards of interest are within the discretion of the bankruptcy courts and arise under federal law. That statement may have been true in 1946, but Vanston Bondholders must be considered in its historical context, and that context no longer applies.

Vanston Bondholders was decided under the Bankruptcy Act which was repealed upon enactment of the Bankruptcy Code. The Act, like the Code, contained a general prohibition against

post-petition interest. It did not contain, however, any statutory exceptions like § 506(b) or § 726(a)(5). Because the statutory scheme was considered inequitable, the courts created several equitable exceptions which are administered on a case by case basis. This Court recognized two such exceptions in United States v. Ron Pair Enterprises, Inc., 109 S.Ct. 1026 (1989). The first exception provided interest to creditors if the estate proved solvent. That exception is now codified at § 726(a)(5). The second exception allowed creditors whose claims were secured by income producing securities to apply the income to post-petition interest. That exception no longer exits as such, although it has been incorporated in part in the cash collateral provisions of § 363. A third exception allowing interest to oversecured creditors was deemed to be of "more doubtful provenance." Ron Pair, 109 S.Ct. at 1033. That exception is now codified at § 506(b).

Because there were no statutory exceptions in the Act to the prohibition against post-petition interest, any such exceptions had to be judicially created and awards of interest could only be within the discretion of the courts. In awarding interest, the courts attempted

to "balance the equities" between the various creditors and the debtor. Petition, p. 44. Under the Bankruptcy Code, equity balancing is no longer necessary or appropriate. § 506(b) provides that interest shall be allowed to oversecured creditors. § 726(a)(5) provides that interest shall be allowed to unsecured creditors at the legal rate. The statutory language is mandatory, not discretionary. The courts are not asked or authorized to consider the effect of allowing interest to one creditor on other creditors or the debtor.

Petitioner's analysis also fails to address another key issue. In this case there is an alleged conflict between a federal statute and a state law contract right. As articulated in Ron Pair, however, § 506(b) applies to non-consensual lienholders as well. Petitioner neglects to mention that if this Court adopts its analysis, it will create a real conflict between § 506(b) and 26 U.S.C. § 6621 two federal statutes. [§ 6621 is the statute pursuant to which the interest rate on federal tax liens is calculated.] As this Court will no doubt recall, the creditor in Ron Pair was the Internal Revenue Service, an agency of the federal government.

5. THE FEDERAL JUDGMENT RATE AND § 726(a)(5) HAVE NO RELEVANCE TO RESOLUTION OF THE INTEREST RATE TO BE ALLOWED UNDER § 506(b).

Petitioner's final argument, that the federal judgment rate is logical, practical and equitable, is an incorrect statement of fact and has no legal basis. § 726(a)(5) has no logical relevance to a determination of the interest rate under § 506(b). Section one above contains a detailed comparison which need not be repeated here. It is sufficient to say that there are substantial distinctions in context and application and that any logical nexus between the statutes in minimal. In addition, Petitioner and the Bankruptcy Court contend that the federal judgment rate is logical as the detention of money in a bankruptcy case arises under federal law and is similar to a judgment against estate assets, Laymon, 117 B.R. at 862; Petition, p. 47, and the federal judgment rate is, therefore, an appropriate rate for detaining an oversecured creditor's collateral. Although this simplistic analysis has some visceral appeal, it ignores the more logical comparison to the numerous Bankruptcy Code sections providing for payments to secured creditors in the context of a plan

of reorganization. (After all, Respondent is a secured creditor and this is a reorganization.)

Petitioner's contention that § 726(a)(5) is practical simply ignores the realities of application. What federal judgment rate applies? The rate on the date of filing of the bankruptcy, the date of filing of the motion, the date of the order on the motion, the date of disposition of the collateral, the date of payment of the claim, or does the rate float, changing each time the federal judgment rate changes? Exhibit B to the Bankruptcy Judges order (Petition Appendix, p. A-25) incorporates a floating rate. Since this Chapter 11 was filed September 4, 1984, the federal judgment rate has changed in excess of one hundred times. (The federal judgment rate is based on Treasury bill auctions which occur every four weeks or thirteen times per year.) Changing the interest rate every four weeks for eight years hardly seems "practical" compared to the fixed contract rate.

Finally, Petitioner's argument that the federal judgment rate is "equitable" has no basis in law and is based largely upon factual contentions not supported by the record. Petitioner and the

Bankruptcy Court both appear preoccupied with balancing the equities between the abusive, grasping oversecured creditors and the helpless, downtrodden undersecured creditors, although there is nothing in the record to indicate any impropriety on the part of Respondent. Petition, p. 55; Laymon, 117 B.R. at 863. As recited in Section three above, § 506(b) no longer allows "equity balancing." There is nothing in the language of § 506(b) which would authorize a bankruptcy judge to reduce or deny interest to an oversecured creditor based upon a perceived detriment to any other creditor or the debtor. There is no evidence in the record that allowing interest to Bradford at the contract rate (or any other rate, for that matter) will reduce the distribution to unsecured creditors by so much as one cent.

Petitioner also laments that allowing interest to oversecured creditors at "above market" rates will result in a windfall to those creditors and will encourage them to delay plan confirmation solely to retain those rates. Petition, p. 50. There is nothing in the record to support Petitioner's contention that the contract rate is above market. (Petitioner raises this issue for the first time at this stage of

the appeal.) The contract rate in this case is ten percent per annum, hardly a windfall. Allowing a creditor to receive what it is contractually entitled to is hardly a windfall, either. The only "windfall" in this case is to the debtor who seeks to avoid his contractual obligations. Finally, Petitioner's contention that allowing interest at the contract rate will encourage delay is disingenuous at best. The Petitioner was appointed as the Chapter 11 Trustee in this case on March 6, 1987, over five years ago. The Petitioner has never filed a plan in this case. Any delay in this case has resulted entirely from the Petitioner's failure to conscientiously pursue the duties imposed upon him.

Petitioner's analysis overlooks a great deal of law regarding conflicts between federal bankruptcy law and non-bankruptcy entitlements. In Butner v United States, 99 S.Ct. 914,918 (1979), this Court stated:

> Property interests are created and defined by state law. Unless some federal interest required a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a state serves

> to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving happenstance of bankruptcy. [Citation omitted.]

See also, Wardair Canada, Inc v. Florida Department of Revenue, 106 S.Ct. 2369 (1986). Nothing contained in § 506(b) "requires" that Respondent receive anything other than that to which he is entitled under applicable non-bankruptcy law.

CONCLUSION

Although entitlement to interest in this context is clearly a question of federal law, the rate at which such interest is to be allowed is not addressed by the Bankruptcy Code. the majority rule under the Bankruptcy Act was to allow interest to oversecured creditors at the rate provided in the contract. As there is no indication that Congress intended to change prior practice or to abrogate non-bankruptcy entitlements, Respondent is entitled to

retain his property interests. Respondent requests that this Court deny the Petition for Writ of Certiorari.

Respectfully submitted,

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